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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1946.

No.....

CITIES SERVICE GAS COMPANY, a corporation,
PETITIONER,

vs.

FEDERAL POWER COMMISSION; PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI; the CITY OF KANSAS CITY, MISSOURI; STATE CORPORATION COMMISSION OF KANSAS; and CORPORATION COMMISSION OF THE STATE OF OKLAHOMA, RESPONDENTS.

Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Tenth Circuit.

Cities Service Gas Company, petitioner herein (referred to as "Company" or "petitioner"), respectfully prays that this Court issue its writ of certiorari to review the final judgment of the United States Circuit Court of Appeals for the Tenth Circuit (referred to as "Court of Appeals") *(R.V. 3, p. 1349)* affirming a final order of the Federal Power Commission (referred to as "Commission") under the "Natural Gas Act" of 1938, which order found that "the rates and charges made, demanded or received by the Company for and in connection with its transportation and sale of natural gas in interstate commerce for resale for ultimate

public consumption are unjust, unreasonable and excessive by at least $5,499,665 based upon the Company's operations during the test year 1941" *(R. V. 1, p. 69)*.[1] The Commission thereupon directed that "the rates and charges * * * be so reduced as to reflect * * * a reduction of not less than $4,445,871 ($5,499,665 less $1,053,794) below its 1941 operating revenues * * *" *(R. V. 1, pp. 69-70)*. Application for rehearing was made and denied *(R. V. 1, pp. 70-71)*.

OPINIONS BELOW.

The opinion of the Court of Appeals, Judge Phillips dissenting *(R. V. 3, pp. 1323-1349)*, in case entitled *Cities Service Gas Company v. Federal Power Commission, et al.*, is reported in 155 Fed. (2d) 694. The opinion and order of the Commission *(R. V. 1, pp. 28-70)* is reported in 50 P.U.R. (n.s) 65.

JURISDICTION.

The judgment of the Court of Appeals was entered April 30, 1946 *(R. V. 3, pp. 1349-1350)*. Petition for rehearing, filed herein on July 1, 1946 *(R. V. 3, pp. 1351-1392)*, was overruled July 5, 1946 *(R. V. 3, p. 1393)*. To such petition for rehearing and supporting memorandum brief the consideration of this Court respectfully is invited *(R. V. 3, pp. 1351-1392)*.

The jurisdiction of this Court is invoked under *Section 347 (a) (Section 240, amended) of the Judicial Code (U.S. C.A., Title 28, Section 347(a)) and Section 19(b) of the Natural Gas Act (52 Stat. 821; 15 U.S.C.A., Sec. 717 r (b))*.

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[1]The Commission further found:

"Due, however, to the necessity for relieving the gas transportation shortage in the Mid-Continent area, and in order to expedite the construction of a proposed 26-inch main transmission pipe line to the Hugoton Gas Field and other facilities required to produce and transport gas from such field, it is in the public interest, for the purpose of this interim order, to make an additional allowance of $1,053,794 in the cost of service for the Company's gas sales subject to the Commission's jurisdiction;

"The natural gas rates and charges of the Company subject to the Commission's jurisdiction should be reduced by not less than $4,445,871, as hereinafter provided;"

STATUTE INVOLVED.

The statute involved is the Natural Gas Act *(52 Stat. 821; 15 U.S.C.A., Sec. 717)*, the pertinent provisions of which are set forth in *Appendix A, infra.*

QUESTIONS PRESENTED.

For clarity, it is necessary that each of the "Questions Presented" be preceded by a statement of the particular issue of law and fact involved, based upon the record herein.

1.

Administrative "Jurisdiction of the Commission and Scope of Review."

(1) The Court of Appeals, Judge Phillips dissenting, under the foregoing subject caption and elsewhere throughout its opinion herein, indulged and acted upon its assumption that the reviewing court is without authority of law to perform any real function of "limited" judicial review as contemplated and provided by *Section 19(b)* of the Gas Act[2] *(R. V. 3, pp. 1327, 1327-1328, 1339)*. Accordingly, the review in this case, under the announced concept of the Court of Appeals as to the meaning of *Section 19(b)* of the Gas Act,

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[2]Section 19 of the Gas Act provides in substance:

The provision for rehearing before the Commission provides that such application "shall set forth *specifically* the ground or grounds upon which such application is based," not merely a general objection that the finding of "unreasonableness" is "arbitrary." Thus the Commission is given opportunity to correct its errors, on the assumed concept that "true wisdom always is discreet, and not ashamed of wise retreat."

The judicial review before the Court of Appeals, predicated *solely* upon the "transcript of the record" before the Commission, provides: "No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing * * *," which means that all such objections so urged shall be considered by the reviewing Court; "The finding of the Commission as to the *facts, if supported by substantial evidence*, shall be conclusive," or conversely, if not supported by "substantial evidence," cannot stand; and "The judgment and decree of the Court, affirming, modifying or setting aside, *in whole or in part*, any such order of the Commision, shall be final * * *." Herein in *plain language*, the statute provides that usual and ample statutory review of orders of administrative agencies, developed and established by long legislative and judicial practice and the undoubted applicable law of the land at the time of the passage of the Natural Gas Act.

and in general reliance upon certain opinions and decisions of this Court, became merely a glorified formality of approbation and approval.[3]

The question presented then is: Whether the Court of Appeals, in so construing and applying *Section 19(b)* of the Gas Act, has proceeded in conformity with the correct rule of law.

(2) The Court of Appeals, throughout the majority opin-

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[3]The Court of Appeals did not undertake to define and declare its own functions and duties as the Court of review, but by its repeated assertions and conclusions as to the finality of the administrative process disclosed a philosophy wholly at variance with any real or effective judicial supervision and review whatever. It declared, among other things:

"It is of first importance to take account of the respective provinces assigned to the Commission and the Courts on review in order that we may perform the functions assigned to us *without trespass upon the administrative prerogatives*" (*R.V. 3, p. 1327*).

"In delineating the scope of review, the Courts have left no doubt of their disposition to give the Commission a *free rein* in the effectuation of the Congressional purpose. The *administrative process is no longer fettered by judicial notions of the 'economic merits' of the rate order.*" (*R.V. 3, p. 1327*).

"It hardly seems necessary nor appropriate to reiterate what has already been so emphatically said concerning the '*broad area of discretion*' committed to the Commission * * *" (*R.V. 3, p. 1327*).

"It is said that a *finding of reasonableness* made after a full hearing by the Commission is the product of 'expert judgment,' which carries with it a strong presumption that it meets the statutory requirements" (*R.V. 3, p. 1328*).

These postulates the Court of Appeals applied, as follows:

"And since the constitutional requirements are no more exacting than the statutory standards of the Act, there is an *almost conclusive presumption* that the order which meets the statutory standards does not exceed the bounds of due process" (*R.V. 3, p. 1328*).

"But if, under the prevailing view, the economic merits of a rate base is of no judicial concern, * * *, we have not the right to intercede *unless it is conclusively shown that failure to give consideration to the fair value of properties, including the valuable leasehold estates, will prevent the company from operating successfully as a public utility*" (*R.V. 3, p. 1332*).

"*If some of the specific allocations appear to be illogical and unfair, they necessarily pose technological problems of accounting and finance upon which the administrative judgment has been declared virtually supreme. We shall not criticize that which we are powerless to correct*" (*R.V. 3, p. 1339*).

"If allocation of cost of service is a fundamentally correct and permissible method of effecting a separation of the regulable from the non-regulable sales, *we cannot say* on this record *that the application of the formula is so wholly unrelated to the facts* as to produce an illegal or reversible result" (*R.V. 3, p. 1339*).

ion herein, repeatedly and progressively asserted and declared that the Commission action and order under review is attended with "an almost conclusive presumption," with "a free rein," with a non-reviewable "area of discretion," and with such a weight and number of presumptions and assumptions that the reviewing court is "powerless" to examine, to correct, or to "criticize" Commission action, even though it be "illogical and unfair," that is, arbitrary or capricious *(R. V. 3, pp. 1327-1328, 1335, 1336, 1337, 1339)*.

The question presented then is: Whether, on review, Commission findings are "virtually supreme" and non-reviewable *(R. V. 3, p. 1339)* unless "it is conclusively shown" by the petitioner that the Commission action "will prevent the company from operating successfully as a public utility" *(R. V. 3, p. 1332)*, or unless the Commission conclusion is "wholly unrelated to the facts" *(R. V. 3, p. 1339)*, "the statutory standard of 'fair and reasonable' ", *Section 19(b)* of the Gas Act and other law of the land to the contrary notwithstanding.

(3) The Court of Appeals, speaking through Judge Murrah, by its assertions that Commission action for various assigned reasons is "virtually supreme" *(R. V. 3, pp. 1328, 1332, 1339)* and is attended by presumptions that dispense with the requirements of basic proof *(R. V. 3, pp. 1333, 1335, 1336, 1337)*, declared, in effect, that if the reviewing court actually undertakes to review the record to determine whether the Commission addressed itself to the evidence, whether its findings are supported by "substantial evidence" or whether its conclusions are "fair and reasonable" or unfair, illogical, arbitrary or capricious, such judicial procedure would constitute an unlawful "trespass upon the administrative prerogatives."

The questions presented then are:

Whether Commission action in effect is immune from judicial review "as to the facts."

Whether the result of review lawfully may be predetermined by the presumptions, assumption and rules of law as announced by the Court of Appeals herein before the judicial inquiry is launched.

2.

"Regulation of Producing and Gathering of Natural Gas."

The Commission in its opinion and order herein *(R. V. 1, pp. 37, 50)* included all the production properties and gathering facilities of petitioner "in the rate base" and similarly and directly included, as subject to its rate-regulatory authority, all operations, revenues, expenses, return and depreciation of such properties and operations as an inherent part of its rate reduction order herein *(R. V. 1, pp. 52, 57-58)*.

This action of the Commission the Court of Appeals, Judge Phillips dissenting, approved on the ground that such jurisdiction had been "squarely met and conclusively decided" in favor of the Commission assertion of such authority *(Canadian River Gas Co. v. Federal Power Commission,* 324 U.S. 581, 65 S. Ct. 829). In that case *a minority only of this Court* (Justices Douglas, Black, Murphy and Rutledge) declared that despite the specific exclusion by the terms of *Section 1(b)* of the Gas Act, nevertheless the Commission possessed rate-regulatory authority over "the production or gathering of natural gas," save and except "the Commission has no control over the drilling and spacing of wells and the like. It may put other limitations on the Commission." Thus the meaning and scope of the statutory language in question, which is directly involved in this case, has been clouded and not been settled as yet by any "authoritative precedent" of this Court, which to be authoritative must be participated in by not less than five Justices concurring on "the principles of law involved" *(United States v. Pink,* 315 U.S. 203, 62 S. Ct. 552, opinion by Mr. Justice Douglas).

The question presented then is: Whether the provisions of the Gas Act shall apply to the production or gathering of natural gas, contrary to the express and specific prohibition of *Section 1(b)* of the Act.

3.

Rate Base of Natural Gas Reserves.

The Commission herein *(R. V. 1, pp. 31-32)* assumed as a matter of law in reliance upon its own decisions in *Detroit v. Panhandle Eastern Pipe Line Company,* 45 P.U.R. (n.s.) 203, 208-210, and *Re Chicago District Electric Generating Company,* 39 P.U.R. (n.s.) 263, 269-272, and as "an inexorable rule" that it was required by *Section 6(a)* of the Gas Act to predicate its rate base, including gas reserves and leaseholds, for the purpose of its inquiry into "the reasonableness of rates and charges" solely upon "actual legitimate cost," so-called, if, as was found to be the fact in this case, such "cost" is "accurately ascertainable from the books and records" *(R. V. 1, p. 32; R. V. 3, p. 1330).* The actual fair value of the reserves and leaseholds the Commission held to be "immaterial and irrelevant" *(R. V. 3, p. 1331).*

This Court has declared repeatedly to the contrary that, in the determination and fixation of a rate base, "the Commission was not bound to the use of any single formula or combination of formulas in determining rates. Its rate-making function, moreover, involves the making of 'pragmatic adjustments.' When the Commission's order is challenged in the Courts, the question is whether that order 'viewed in its entirety' meets the requirements of the Act. Under the statutory standard of 'just and reasonable,' it is the result reached, not the method employed, which is controlling" *(Federal Power Commission vs. Hope Natural Gas Company,* 320 U.S. 591, 64 S. Ct. 281).

The Court of Appeals, Judge Phillips dissenting, ignored completely the "erroneous view of the law" adopted by the Commission, as well as the controlling principles declared by this Court, and sought to justify the Commission order by the quotation of part of a statement made by Mr. Justice Douglas in the *Canadian* case *(324 U.S. 581, 604, 65 S. Ct. 829, 841), supra,* where it is said: "Hence we cannot say as a matter of law that the Commission erred in including the production properties in the rate base at actual legitimate cost" *(R. V. 3, pp. 1332-1333).* The Court of Appeals, how-

ever, did not refer to or quote the remainder of the same statement of Mr. Justice Douglas, which was: "That could be determined only on consideration of the end result of the rate order, a question not here under the limited review granted the case." Obviously the entire statement of Mr. Justice Douglas does not carry the meaning attributed to it by the Court of Appeals in its partial quote therefrom. Thus, neither the Commission nor the Court of Appeals "proceeded under a correct rule of law."

The "end result" is that vast gas reserves, admittedly of very great actual value, were included in the Commission rate base at nominal amounts or at zero dollars *(Op. of Ct., R. V. 3, pp. 1329-1333. See Dissent. Op., R. V. 3, pp. 1342-1346).*[4]

The Commission, under its self-imposed rigid "cost" rule, precluded itself from any consideration of "pragmatic adjustments which may be called for by particular circumstances" or of "the statutory standard of 'just and reasonable' "; and the Court of Appeals bluntly refused *(R. V. 3, pp. 1332-1333)* to enter into any process of review whatever or even to examine into or determine whether "the Commission's order, as applied to the facts before it and viewed in its entirety, produces an arbitrary result," which is its judicial function and duty *(Federal Power Commission v. Natural Gas Pipeline Co.,* 315 U.S. 575, 586, 62 S. Ct. 736, 743).

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[4]This Court as yet has not considered in any case the "end result" of an order of rate reduction where as here the natural gas leaseholds and reserves were included in the rate base at Commission "cost."

In the *Hope Natural Gas Company* case, *supra,* as pointed out by Judge Phillips (*R.V. 3, p. 1347*), the issue of fair value of gas reserves was not involved, and "the Company on the other hand has not put its gas fields into its calculations on the present value basis * * *" (*320 U.S. 596, 645, 64 S. Ct. 281, 308*).

In the *Natural Gas Pipeline Company* case, *supra,* the natural gas reserves were reflected in the rate base at "fair value" (*315 U. S. 575, 580, 586, 62 S. Ct. 736, 740, 743*).

In the *Panhandle Eastern Pipe Line Company* case, *supra,* (*324 U. S. 635, 638, 65 S. Ct. 821,823*) as in the *Canadian River Gas Company* case, *supra,* (*324 U. S. 581, 605-6, 65 S. Ct. 829, 841*) the review in this Court was limited and did not embrace the question of "end result" of the ordered rate reduction, based upon a Commission "cost" rate base.

The questions presented then are:

Whether the Commission in its determination of rate base lawfully may refuse to consider or receive in evidence, as a matter of law, any and all evidence of the fair and actual value of gas reserves and producing properties, on the premise that it is required by *Section 6(a)* of the Gas Act to consider "cost" and cost alone when such cost is "accurately ascertainable."

Whether the Court of Appeals, as the reviewing court, may abdicate its functions of review under *Section 19(b)* of the Gas Act, or lawfully may evade and refuse to pass on and decide the propriety of such Commission action (1) under the erroneous view of the law entertained by that body, (2) as measured by "the statutory standard of 'just and reasonable,'" and (3) whether "The Commission's order, as applied to the facts before it and viewed in its entirety, produces an arbitrary result."

Whether evidence of fair value of gas reserves and production properties must be received in evidence in connection with the Commission determination of rate base to enable that body: to make an informed determination of the proper and fair formula or combination of formulas which should be used in the particular case; "to make the pragmatic adjustments which may be called for by particular circumstances"; to insure that its order "as applied to the facts before it and viewed in its entirety produces no arbitrary result"; and to permit the reviewing Court, as is its duty, to examine and decide, on the record in the case and not at large, whether the Commission has confined itself to the facts before it or has otherwise abused its "administrative prerogatives" by indulging in unreasonable, unfair, arbitrary or illegal action.

4.

"Existing Depreciation and Depletion."

The Commission made the following finding:

"The Commission's staff presented a complete depreciation and depletion reserve requirement study, i.e., a computation of the reserves which should have been ac-

crued had the Company properly recorded in reserves the accumulated cost of the property consumed in service. *A qualified staff engineer inspected the Company's properties,* analyzed its past experience and that of its predecessors, and estimated the overall service lives of the property by classes. *He considered* service life data on other pipe lines, and *treated realistically both the physical and functional aspects of depreciation."* (Emphasis added.)

(R. V. 1, p. 44.)

The vital *(R. V. 1, pp. 428, 430)* portion of the foregoing finding, "A qualified staff engineer inspected the Company's properties," is without support in and contrary to the record. The "staff engineer" referred to admitted directly and specifically on cross-examination that not a single actual field inspection was made by the Commission of any part of the pipeline system of petitioner *(R. V. 1, pp. 450-451, Op. of Ct., R. V. 3, pp. 1334-1335),* which system of more than 4300 miles of pipeline constitutes more than 70% of the Commission total "actual legitimate cost" rate base adopted in this case *(Comm. Ex. 5, pp. 977-978; R. V. 1, p. 50).* The purpose of "the field inspections," also referred to as "field examination," the witness testified in detail was "to observe" and ascertain the actual physical condition and "existing depreciation" of the property *(R. V. 1, pp. 428, 430).* As summarized by the Court of Appeals, "He did make a field inspection of the Company's properties for the purpose of observing physical deterioration * * * and other conditions which would affect his judgment of the service life of the property" *(R. V. 3, p. 1334).*

The Court of Appeals, fully aware of the failure of the evidence to support the basic Commission finding in question *(R. V. 3, pp. 1334-1335),* made a finding of its own excusing the "staff engineer" for not making the "inspections" in question. The Commission made no such finding. The finding of the Court, of course, was in substitution for the discredited Commission finding and to justify and support on other grounds the Commission conclusions *(R. V. 3, pp. 1334-1335),* which rested on the Commission staff's inspection and studies *(Comm. Ex. 15, R. V. 3, pp. 1127-1142).*

In other respects, later herein considered, the Commission findings on depreciation are without support in and contrary to the evidence *(R. V. 1, pp. 45-46, 207-208)*.

The questions presented then are:

Whether the unsupported findings of the Commission lawfully can be permitted to support or contribute to the support of the Commission conclusions as to "existing depreciation."

Whether the Court of Appeals is "authorized under *Section 19(b)* to make findings and substitute them for those of the Commission."

5.

Natural Gasoline Operations of Cities Service Oil Company.

The record discloses without contradiction that certain of the natural gas produced or purchased by petitioner, Cities Service *Gas* Company, is, under contract, treated in the natural gasoline extraction plants of Cities Service *Oil* Company (situated as much as 250 miles from field points of production, *R. V. 3, p. 1125, Map)*, an affiliate company which is not a "natural gas company" under the Gas Act. This petitioner admittedly never has had any title or interest whatever in any of said plants or in their operation. The Commission nevertheless segregated the natural gas extraction plants of the *Oil* Company from the other properties of the *Oil* Company and treated such plants and the operation thereof "as if they belonged to petitioner" *(Op. of Ct., R. V. 3, pp. 1335-1337; R. V. 1, pp. 53-55; R. V. 2, pp. 792, 802)*. See dissenting opinion, Judge Phillips *(R. V. 3, pp. 1347-1349)*. The Commission thereupon embarked on a rate case. It set up a "cost" rate base (after "some inspection," *R. V. 2, pp. 771-773)* covering the gasoline extraction plants in question and allowed the *Oil* Company 6½% return on such rate base depreciated, but made no allowance whatever to the *Oil* Company for Federal income taxes *(R. V. 2, pp. 805, 806; R. V. 3, p. 1021)*. All other earnings (upon natural gas sold both under regulable sales and under non-regulable sales), averaged over a four-year period at $380,000 a year and described as "average annual excess profits," resulting

from the gasoline extraction operations, were not added to operating revenues but were credited by the Commission to "the operating expenses" of this petitioner *(R. V. 1, p. 56)*.[5]

The Court of Appeals sustained the Commission action on the *factual assumption* that "the extraction process was *a necessary function* of the business of transporting and delivering natural gas to market by means of a pipeline system and that such process was *essential* to the transportation and sale of natural gas" *(R. V. 3, p. 1336)*. *The Commission made no such finding*, and on the record could not have made such a finding. It found generally that "This operation is profitable and *renders the natural gas more readily marketable and transportable" (R. V. 1, p. 53)*. But, even this mild finding is not supported by and is contrary to the record herein *(R. V. 2, pp. 775, 776; Ex. 14, p. 1125)*.

Neither the Commission *(R. V. 2, pp. 792, 802)* nor the Court of Appeals *(R. V. 3, p. 1336)* noticed or respected the salutary and controlling principle of law that the *Oil* Company "is to be treated as a segregated enterprise" even though the affiliate relation "may demand close scrutiny" *(Smith v. Illinois Bell Telephone Co.*, 282 U.S. 144, 151-153, 51 S. Ct. 65, 67, 70).

The questions presented then are:

Whether the Commission lawfully may exercise rate-regulatory authority over the separate and independent natural gasoline extraction plants of Cities Service *Oil* Company and the operation thereof, precisely the same "as if they (such plants and operations) belonged to petitioner," Cities Service *Gas* Company.

Whether the Court of Appeals may, in the discharge of its judicial functions under *Section 19(b)* of the Gas Act, (1) disregard as immaterial and irrelevant the principle of law that, while the reasonableness of dealings between affiliates, if not at arm's length, may be inquired into, each continues

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[5]The effect of this accounting manipulation, upon the Commission's "cost of service" which is the basis of the "cost of service allocation" will be considered under the subject title "Allocation of Cost of Service," *infra*.

to be and must be treated as a separate and segregated enterprise, or (2) make findings and substitute them for those of the Commission.

6.

Federal Income Taxes.

The Commission refused to allow as deductible expense any Federal income tax whatever on the theory that the elimination of "the sum of $1,882,142 (that is: the entire Federal income tax liability of petitioner for the year 1941 on the basis of the Commission's computation *(Comm. Ex. 41, R. V. 3, pp. 1264-5))* represents the reduction in the Company's 1941 Federal income tax which would have resulted if the net utility income (that is, on both jurisdictional and non-jurisdictional business) had not exceeded a 6½% return on the rate base of $48,567,756" (that is, the total Commission "rate base" covering both jurisdictional and non-jurisdictional properties and operations *(R. V. 1, p. 50)) (R. V. 1, p. 57, note, 57-58).*[6]

"The effect of the disallowance was to assign all Federal income tax liability for the year 1941 to non-regulable sales" *(Op. Ct., R. V. 3, p. 1337)* in excess of 6½% return on the Commission overall "rate base." In fact the Commission did not reduce merely, it eliminated entirely, all Federal income taxes from this case *(Comm. Ex. 10, Sch. 4, R. V. 3, p. 1013).*[7]

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[6]The procedure was quite different in *Colorado Interstate Gas Co. v. Federal Power Comm.*, 324 U. S. 581, 587, 65 S. Ct. 829, 832. Federal income taxes there were included in deductible expenses and were reflected in the "cost of service" and in the "cost of service allocation" as stated by Mr. Justice Douglas in that case as follows: "And one-half of the return and income taxes on the Denver pipeline and one-half of operating labor of the compressing system were classed as volumetric, the other half being classed as capacity." Here, on the other hand, *only* "State income taxes" were treated as deductible expense and reflected in the "cost of service" and "cost of service allocation." Such State income taxes then "were allocated 50% to 'commodity' and 50% to 'demand.'" *(R.V. 1, p. 60).*

[7]The amount of Federal income taxes for 1941 eliminated by the Commission under its theory of tax liability was $310,592. There are no Commission findings on the subject *(R.V. 1, p. 57 note).* However, the amount can be arrived at approximately by applying to the staff's method of computation *(Comm. Ex. 41, R.V. 3, pp. 1264-1265)* the amounts of the various items involved as actually incorporated into the Commission opinion and order:

The Court of Appeals obviously was inaccurate, if not confused, for it declared: "The disallowance is based on the thesis that if the rates and charges on the *regulable sales* had not exceeded an amount sufficient to return 6½% on the adopted rate base, the tax liability would not have been incurred, consequently it cannot be allowed as an expense" *(R. V. 3, p. 1337)*. Thus the Commission theory and the Court's concept of that theory are divergent. However, both Commission and Court of Appeals proceeded on *the legal theory* that the Commission has rate-regulatory authority with respect to *all* earnings over 6½% on the Commission overall rate base, whether such earnings be derived from the "regulable sales" for resale or the "non-regulable sales" for direct consumption *(R. V. 1, p. 57, note, 57-58, R. V. 3, p. 1337)*. This is so stated by the Court of Appeals, *referring to earnings on the "non-regulable sales" in excess of 6½% return,* as follows: "The petitioner may not charge as an expense that which it cannot lawfully earn" *(R. V. 3, p. 1337)*. This statement is made, notwithstanding *Section 1(b)* of the Gas Act, *Panhandle Eastern Pipe Line Co. v. Federal Power Comm.*, 324 U.S. 635, 641-642, 65 S. Ct. 821, 825, and *Colorado Interstate Gas Co. v. Federal Power Comm. (Mr. Justice Douglas)*, 324 U.S. 581, 588, 65 S. Ct. 829, 833, which

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Taxable income for 1941 per Federal income tax return filed	$6,057,181.46
Adjustments by staff:	
Processing earnings (Natural gasoline extraction "excess profits"—*R.V. 1, p. 54*)	380,000.00
Price of purchased gas	65,203.76
Adjusted taxable income before applying Revenue Reduction	$6,502,385.22
Revenue Deduction (*R.V. 1, p. 61*)	5,499,665.00
(Note: The Hugoton allowance of $1,053,794 (*R.V. 1, p. 63*) does not enter into this computation for no tax deduction of any kind was reflected therein.)	
	$1,002,720.22

Computation of Tax

Normal tax—24% of $1,002,720	$ 240,652.00
Surtax:	
6% of $25,000	1,500.00
7% of $977,719	68,440.00
	$ 310,592.00

declare in conformity with the statute that it is immaterial what the revenues and earnings from the non-regulable sales may be, since the authority to regulate these phases of the business is lacking.

It is to be noted also that *all* revenues from all sources *(R. V. 1, p. 52)* and *all* expenses and deductions of every sort except Federal income taxes *(R. V. 1, p. 58; R. V. 3, pp. 1191, 1209, 1264)* are reflected in the Commission conclusion as to "Income Available for Return to Company" *(R. V. 1, p. 58)*. The stated amount, after deduction of "Annual Return of 6½% on Rate Base"—that is, 6½% return from both "regulable sales" and "non-regulable sales" upon the Commission *overall* "rate base," embracing both jurisdictional and non-jurisdictional properties and operations, is used as the base described as "cost of service" for the "cost of service allocation," so-called *(R. V. 1, pp. 58, 61)*. Consequently, the item of Federal income taxes is excluded in its entirety as a proper and lawful expense deduction. See dissenting opinion, Judge Phillips *(R. V. 3, p. 1349)*.

Had Federal income taxes been reflected, as in the *Colorado Interstate Gas Company* and *Colorado-Wyoming Gas Company* cases, one-half of the $310,000 of such income taxes, to-wit: $155,000, would have been allocated to the regulable sales and operations and the rate reduction herein would have been $155,000 less than actually was ordered.[8]

The questions presented then are:

Whether the Commission reasonably and lawfully may refuse to reflect Federal income taxes as a deductible expense in the overall computation of "operating expenses, depreciation and depletion expense, taxes and exploration and development costs," as was done *(R. V. 1, p. 58)*.

Whether the Commission reasonably and lawfully may refuse to consider or reflect Federal income taxes in the base figure of "expenses and return" adopted by it for the "cost of service allocation," so-called *(R. V. 1, pp. 58, 61)*.

Whether the Court of Appeals, in approving the exclusion of all Federal income taxes from "expense," from "cost of service," and from the "cost of service allocation,"

by the Commission, as "legally justified" *(R. V. 3, p. 1337)*, has performed its judicial function under *Section 19(b)* of the Gas Act or has proceeded under the correct rules of law.

7.

Allocation of Cost of Service.

The Commission adopted the so-called "demand and commodity" method for allocating costs *(R. V. 1, p. 59)*. It gave no consideration whatever as to whether, under the requirement that it "must make a separation of the regulated and unregulated business" *(Panhandle Eastern Pipe Line Co. v. Federal Power Comm.*, 324 U.S. 635, 65 S. Ct. 821, *Colorado-Wyoming Gas Co. v. Federal Power Comm.*, 324 U.S. 626, 635, 65 S. Ct. 850, 854), a separate allocation of investment and operating cost between the regulable and non-regulable properties was necessary in this case. The general method here employed was utilized in the *Colorado Interstate Gas Company* case. With respect to such method, Mr. Justice Douglas in that case declared: "The problem is to allocate to each class of the business its fair share of the costs. * * * Allocation of costs is not a matter for the slide rule. It involves judgment on a myriad of facts. * * * Under this Act the appropriateness of the formula employed by the Commission in a given case raises questions of fact not of law. * * * Considerations of fairness, not mere mathematics, govern the allocation of costs" (324 U.S. 581, 589, 591, 65 S. Ct. 829, 833, 834).

There are no Commission findings of fact disclosing the governing "considerations of fairness" or what "judgment" factors entered into the adoption of "the staff's method" and the Commission's ultimate conclusion that such method "as applied was fair and reasonable" *(R. V. 1, pp. 59-61)*. "Mere mathematics," molded by the desires of the Commission, in fact controlled, as the record discloses *(R. V. 1, pp. 55, 57, 58, 61; R. V. 3, pp. 1187-1213)*.

We illustrate from the record certain of the manipulative devices of allocation by which the Commission can and does at will control, without restraint, the basis and foundation of its so-called "cost of service allocation."

The Commission, *as a part of and for the sole purpose of*

its so-called "cost of service allocation," excluded entirely *all* Federal income taxes (in excess of $310,000) from deductible expenses, and therefore from the base figures of "cost of service" *(R. V. 1, p. 57)*. Such elimination was not based on any finding of fact whatever, or on any disclosure of "considerations of fairness," or factors of "judgment" but rests purely on an "if" and untrue supposition *(R. V. 1, pp. 57, note, 58, 61)*.

Similarly, and again *as a part of and for the sole purpose of its so-called "cost of service allocation,"* the Commission "concluded" that *the operating expenses* of this petitioner should be "credited" annually with the asserted "average annual excess profits" of $380,000 a year from the natural gasoline extraction operations here in question *(R. V. 1, p. 55)*. This procedure, as intended, operated directly to reduce the "total cost of service" by the amount of $380,000 a year and the "cost of service" allocated to the regulable business by $224,700 a year *(R. V. 1, p. 58; Comm. Br., Ct. of Appeals, p. 37 note)*. Aside from the overall illegality of the expropriation of certain of the Cities Service *Oil* Company natural gasoline extraction plants, business and earnings *(R. V. 1, pp. 53-55; R. V. 2, pp. 771-773, 792, 798, 800, 802, 1021)*, the "revenue from processing natural gas" is required to be credited to "gas revenues" *(Comm. System of Accounts, Sec. 617. See also Section BA 747, 1, and note, R. V. 3, pp. 1244-1245)*. This is so because the item is in fact a revenue item and not an expense item.[5]

The Commission thus refused to permit either of the foregoing items or any part thereof to enter into the overall or allocated "cost of service" *(R. V. 1, p. 61)*.

The Court of Appeals flatly refused to examine, consider, criticize or review any part of the so-called allocation process indulged by the Commission, on the ground that the administrative action is final and the reviewing court is without any authority whatever of any kind in the premises *(R. V. 3, p. 1339)*.

The questions presented then are:

Whether the Commission order in the absence of "the basic and essential findings on which administrative orders rest" can stand.

Whether the ultimate conclusion of the Commission that its allocation is "fair and reasonable" is subject to judicial inquiry and review, to ascertain whether the Commission addressed itself to the evidence, whether the evidence is sufficient and whether the Commission conclusion is "fair and reasonable" or capricious and arbitrary.

Whether the Court of Appeals in its refusal in this case to enter into any process of review whatever on the issue of allocation, has proceeded under the correct rule of law *(Sec. 19(b) of the Gas Act)*.

As bearing directly on the so-called "end result" of the rate reduction order herein, the Commission relied upon the dividend and funded debt reduction record of petitioner for "the 16-year period ending November 30, 1942," showing, so it is said, an average return of approximately 14% on the investment in the property, that is, on the Commission "cost" rate base theory *(R. V. 1, pp. 51-52)*.

Whatever dividends were paid and whatever reductions were made in the funded debt during any period in the past were not made under rate schedules conformable to the rate reduction order herein. So just what materiality past earnings under different and higher rate charges could have upon the "fairness and reasonableness" of the rate reduction order herein under review is inexplicable.

The "end result," viewed on the basis of the past financial stability of the company *(Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 64 S. Ct. 281, 288) whatever its merits, encounters insuperable difficulties under the "cost of service allocation" method of the Commission, that is where, as here, there is no separation of the plant, property, operations and earnings of the utility as between the two classes of business—that which is regulated and that which is not regulated.

The 16-year record of Company operations, relied upon by the Commission, related to and covered *all* property, business, operations and earnings of the petitioner, both those now regulated and those not now regulated by the Act. The Commission order of rate reduction herein relates to and covers, and lawfully can relate to and cover, only the

business regulated under the Act. There is no separation in the Commission "cost of service allocation" of the regulated and unregulated properties and business of the petitioner.

The unregulated business lawfully may not be required to carry the regulated business or any part of it, any more than the regulated business lawfully may be required to carry any part of the unregulated business. The earnings from the unregulated business alone might be sufficient to enable the Company to maintain the financial stability of the utility, and yet at the same time the end result of the rate reduction order upon the regulated interstate sales for resale business, to which alone the order is applicable, may be arbitrary. In any event, without a separation of that portion of the properties, operations, expenses and earnings attributable to the regulated business, there is no possible way, other than guesswork, to determine whether the end result of the rate order upon the financial stability of the utility, with respect to that part of the business only which it purports to regulate, is "unjust and unreasonable." The result is that the present and future financial condition of this petitioner, resulting from and the end result of the reduction in the rates of the regulated business only, can not be measured, in fact, in logic or in fairness, without separation of the properties, expenses and earnings attributable to that part of the business.

The question presented then is: Whether here, in order to determine, by the test of resulting financial condition, the reasonableness or arbitrariness of the end result of the rate order, it is necessary that there be a separate allocation of property, operations and earnings between the regulable and unregulable business of this petitioner.

8.

Due Process of Law.

The Commission throughout its opinion has announced general, vague and argumentative ultimate conclusions instead of making a "suitably complete statement" of the facts with respect to the several issues joined herein and thereupon declaring "the basic or essential findings" of facts flowing from substantial evidence "required to support

the Commission's order." Particularly is this true, as the record abundantly shows, as to Commission findings and conclusions, omission of findings, and findings not supported by evidence in relation to "rate base," "existing depreciation," "natural gasoline operations," "federal income taxes" and "allocation" *(R. V. 1, pp. 31-32, 44, 45-46, 53-54, 57, 59-61)*.

The Commission throughout its opinion has misconstrued and misapplied the Natural Gas Act and has ignored controlling law, among other things, with respect to the "scope of its jurisdiction," "rate base," "regulation of producing and gathering properties," "natural gas operations," "Federal income taxes" and "allocation" *(R. V. 1, pp. 31-32, 37, 53-55, 57, 59-61)*.

The Commission has not borne the burden of proof imposed upon it by law, particularly in connection with the issues of "rate base," "existing depreciation," "natural gasoline operations," "Federal income taxes," and "allocation" *(R. V. 1, pp. 31, 43-47, 53, 57, 59-61)*.

The Court of Appeals, on such a record, has denied to this petitioner any real review as provided by *Section 19(b)* of the Act, under the asserted concept of administrative finality and want of power in the reviewing court to consider and act upon patent error *(R. V. 3, pp. 1327, 1328, 1339)*.

The Court of Appeals has denied relevance to the facts, conditions and factors surrounding the exercise of administrative judgment and discretion and has refused to consider, to examine or to review them, on the assigned reason that the Commission has been given a "free rein" in the discharge of its "administrative prerogatives" *(R. V. 3, pp. 1327, 1328, 1339)*.

The Court of Appeals has erected presumption after presumption of such weight and conclusiveness that the statutory review is foreclosed before the judicial inquiry commanded can be launched *(R. V. 3, pp. 1328, 1332, 1339)*.

The Court of Appeals has assumed, as did the Commission, that whatever findings and conclusions the Commission made, *even though unsupported by substantial evidence,* cannot be set aside by the courts unless the contrary is af-

firmatively established by the petitioner *(R. V. 3, pp. 1333, 1336, 1337)*.

The questions presented then are:

Whether this petitioner has been denied the substance of due process by the Commission contrary to the requirements of the Natural Gas Act and Fifth Amendment to the Constitution of the United States.

Whether the Court of Appeals, by its refusal to afford to this petitioner the reality of review, as provided and required by *Section 19(b)* of the Gas Act, has denied to this petitioner due process of law under said Act and the Fifth Amendment to the Constitution of the United States.

SUMMARY AND SHORT STATEMENT OF THE MATTER INVOLVED.

As disclosed in the "Questions Presented," *supra,* the action and rate reduction order of the Commission and the opinions and judgment of the Court of Appeals, both under examination on this review, involve fundamental and grievous errors, relating particularly to: the scope and character of the statutory duty of review imposed by law upon the Court of Appeals; the reach and area of the rate-regulatory authority of the Commission over this petitioner; the manner in which the lawful rate-regulatory authority of the Commission may be exercised; the probative substance of the evidence as to the issues of material fact herein; the propriety and legality of the ultimate findings and conclusions upon which the order of the Commission is predicated, and the propriety of the several conclusions and determinations of the Court of Appeals.

This "Summary and Short Statement" of facts and issues of general materiality is supplemental to the matters set forth, *supra,* under the subject title "Questions Presented."

Petitioner, a subsidiary of Cities Service Company, owns and operates an integrated natural gas pipeline system *(Map, R. V. 3, p. 1181)* consisting of 4300 miles of main, branch and field lines, together with appurtenant and ancillary facilities, including compressor stations, dehydrating and purification plants, storage fields, meter stations and ex-

tensive telephone lines and circuits *(R. V. 1, pp. 30-31; R. V. 3, p. 1324)*.

The system extends from the Texas Panhandle field and various fields in Oklahoma, Kansas and Missouri, to various cities, towns and communities and other places of sale in Oklahoma, Kansas, Missouri and Nebraska, including the metropolitan areas of eastern Kansas and western Missouri.

The present system had its origin in 1904. During the period to 1926, numerous pipelines were constructed by predecessor companies from the then producing Kansas gas fields to Kansas City, Missouri, Lawrence, Topeka, Atchison and cities and towns in Kansas, and to natural gas fields in Oklahoma *(R. V. 3, p. 1324)*.

By 1926, the properties above referred to were acquired by petitioner (prior to 1926 the name thereof was Empire Natural Gas Company) *(R. V. 3, p. 927)*, including the pipeline systems of the original enterprises, The Kansas Natural Gas Company group (in receivership 1912-1921) and the Wichita Natural Gas Company group *(R. V. 3, pp. 1100-1107, 947-953)*.

The pipeline to the Texas Panhandle field was placed in service in 1928, the field lines having been laid and a number of wells drilled in 1927 *(R. V. 3, p. 1107)*.

In the period from 1926, a large expansion of the pipeline system took place. Approximately 50% of the present *mileage* of mains and gathering pipeline system was constructed since the year 1926. This amounts on the "cost" basis also to more than 50% of total plant costs *(R. V. 1, p. 91)* and about 76% of existing property other than reserves *(R. V. 1, p. 32)*.

Prior to the year 1927, when the company first began producing gas from its leases in the Texas Panhandle Gas field, the source of gas supply was from production and purchases in about 125 gas fields located in the states of Kansas and Oklahoma *(R. V. 1, p. 107; R. V. 3, p. 1109)*.

The Texas Panhandle acreage had been in process of acquisition since 1917; years before a portion of that area became a proven and producing field, now known as the Texas Panhandle field *(R. V. 1, pp. 107-109)*.

Petitioner owns extensive proven and producing gas reserves in the Panhandle Field in Texas, the Hugoton Field in Kansas and Oklahoma and numerous other fields in Oklahoma and Kansas *(Op. Ct., R. V. 3, p. 1324.* The reserves in the Hugoton field now are, but in 1941 were not, connected with petitioner's pipeline system *(R. V. 1, p. 84).*

The pipeline system is connected with and is served from the producing wells of the petitioner in the Texas Panhandle and other fields in Kansas and Oklahoma *(R. V. 3, p. 1324).*

The petitioner, in 1941, served from its pipeline system about 265 cities, towns and communities in Oklahoma, Kansas, Missouri and Nebraska under various contracts of "sale for resale" and a considerable number of industrial and other direct sale customers in the same states, of which latter sales 95% in volume were in Oklahoma and Kansas. The "sales for resale" were 61,425,000 M.c.f., aggregating $12,903,500, and the "direct sales were 40,700,000 M.c.f., aggregating $4,335,500" *(Comm. Ex. 17, R. V. 3, pp. 1151, 1324).*

In 1941, the petitioner produced from its own wells 43% of its total natural gas requirements, of which about 46,000,000 M.c.f. were produced in the Panhandle field and about 1,000,000 M.c.f. in Kansas and Oklahoma. Of the gas purchased in that year (61,000,000 M.c.f.), about one-half thereof was purchased in each of the states of Kansas and Oklahoma *(Comm. Ex. 14, R. V. 3, p. 1119).*

The leaseholds and natural gas rights of petitioner in the Texas Panhandle, Hugoton and other Oklahoma and Kansas fields are summarized as of 1941 from the record in accordance with Commission witnesses, exhibits and the opinion of the Commission by Judge Phillips in his dissenting opinion *(R. V. 3, pp. 1342-1344)* as follows:

Leaseholds and Natural Gas Rights
Texas Panhandle Field

	Acres	Per cent of total Acreage	Cost allowed in rate base	Gas reserves 12/31/41 M. c. f.	Production 1941 M. c. f.
	68,086	66.67	zero*	1,089,383,786	
	34,041	33.33	$ 554,697.08	544,679.135	
	10,975	(non-productive)	o	o	
	*Allowance for title papers and title examination		1,776.74		
Total	113,102		$ 556,473.32	1,634,062,921	42,122,613 or 97.83% of petitioner's total production

Oklahoma and Kansas Fields
(exclusive of the Hugoton Field)

	424,969	$ 545,374.18	4,794,964	1,029,157

Hugoton Field

	182,182	$ 542,501.00	1,821,820,000	(not in production in 1941)
Total	720,253	$1,644,349.00		

The total cost of gas produced (including expense of production, depreciation, depletion and return at Commission "cost" rate base) and of purchased gas in 1941, according to the Commission staff, was $3,512,611 *(Comm. Ex. 30, R. V. 3, pp. 1187, 1197-1200. Note:* The material on lower half of page 1198 should appear on lower half of page 1200. Error in arrangement occurred during printing.) The Commission in its opinion and order made no findings, reconciliations or other disclosures whatever as to the adjustments made by it in the Commission staff figures *(R. V. 1, pp. 52-59)*. Accordingly, the staff figures contained in *Commission Exhibit 30,* are used here.

The open field price paid for purchased gas (56,067,333 M.c.f.) was $2,716,722, an average of $.048 per M.c.f. *(Comm. Ex. 16, R. V. 3, p. 1145)*. However, by Commission Exhibit 33 *(R. V. 3, p. 1246)*, the amount of purchased gas is given as 61,314,818 M.c.f., and the cost thereof, according to Commission Exhibit 30 *(R. V. 3, p. 1198)*, was $2,639,789, an average of $.043 per M.c.f. The considerable differences are: in volume, 5,247,248 M.c.f. and in price, $76,933. Again, there

are no findings, reconciliations or other disclosures of any kind in the opinion or order of the Commission, indicating what volume and cost figures the Commission actually adopted, and why *(R. V. 1, pp. 52-59)*.

The figure of $2,639,789 *(Comm. Ex. 30)* obviously includes cost of production, depletion of reserves, depreciation of production facilities and return to the producers from whom the gas was purchased by petitioner.

The total production "cost" (including production expense, depletion of reserves, depreciation of production facilities and return) of petitioner for its own production in 1941 of 43,151,770 M.c.f., therefore, was $872,822 *according to the Commission staff figures (Comm. Ex. 30)*, an average price of $.0202 per M.c.f. *(R. V. 3, pp. 1119, 1197-1200)*. Here again the Commission opinion and order is without findings or other clarifying disclosures.

The natural gas reserves of petitioner were put in the Commission "cost" rate base at $1,644,349 *(R. V. 1, pp. 37, 50)*. Depletion therein to December 31, 1941, counsel for the Commission contended in the Court of Appeals by record references *(R. V. 1, p. 47, footnote 26; R. V. 3, p. 1051)* was $179,100, leaving a net "cost" rate base of $1,465,249, upon which a 6½% return would be $95,241, an average price of $.00201 per M.c.f.

It is to be observed that the 1941 production from two-thirds of the productive acreage (68,086 acres) in the Texas Panhandle field (28,081,742 M.c.f.) carried with it no return or price whatever, there being no rate base for such reserves. Petitioner for such gas was allowed the bare expense of production and nothing else. In short, this vast volume of gas was given to petitioner's customers.

It is also to be observed that the production from the remaining one-third of the productive acreage (34,041 acres) in the Texas Panhandle field (14,040,871 M.c.f.) carried a return or price of $.0023 per M.c.f., to which the Commission added the expense of production.

On the other hand, the 1941 production of gas in the expiring Oklahoma and Kansas fields (1,029,157 M.c.f.) under

the Commission "cost" theory produced a return or price of $.031 per M.c.f., on the basis of a 6½% return of $32,500 on the depleted cost of the reserves of approximately $500,000, to which the Commission added the expense of production.

For the gas produced by petitioner in 1941 in the entire Texas Panhandle field (6½% of $32,500 on the depleted cost of approximately $500,000), petitioner by way of return was allowed by the Commission formula a price of $.0007 per M.c.f. for its production of 42,122,613 M.c.f. For the gas produced by petitioner in the same year in the then expiring Kansas and Oklahoma fields (6½% on the depleted cost of approximately $500,000), petitioner by way of return was allowed by the Commission formula a price of $.0218 per M.c.f. for its production of 1,029,157 M.c.f.

Under the Commission "cost" *rate base,* the Texas Panhandle reserves (113,102 acres, 1,634,062,921 M.c.f.) and the Hugoton reserves (182,182 acres, 1,821,820,000 M.c.f) are put in the *rate base* at a mere shadow of a fraction of a mill per M.c.f. of gas reserves.

On the other hand the reserves in the expiring Kansas and Oklahoma fields (424,969 acres, 4,794,964 M.c.f.) are put in the *rate base* approximately at 11.4 cents per M.c.f of gas reserves *in the ground*—a figure more than twice the open *field* price of natural gas in the area.

In such manner does the Commission rigid "cost" rate base operate, in this case, when applied to the natural gas rights and leaseholds of this petitioner.

In the interest of brevity, such additional record facts relating to each of the several specific issues and questions presented herein, as appear to be necessary or desirable adequately to discuss such issues and questions, will be submitted in the attached brief argument, *post.*

"SPECIAL AND IMPORTANT REASONS" FOR GRANTING THE WRIT OF CERTIORARI HEREIN.

In conformity with the requirements of the applicable rules of this Court, the substantial reasons, discussed with greater particularity in the short brief of the argument hereto attached, which it is contended should move this Court to allow the writ of certiorari herein sought, are summarized as follows:

None of the several issues of fact and law as herein presented as yet have been adjudicated and settled finally by authoritative pronouncements of this Court. There exists a broad public interest comprehending all natural gas companies, all producers of natural gas and the consuming public generally. The present state of uncertainty and confusion, as to the extent of the authority of the Federal Power Commission and the lawful manner of its exercise, as well as the duty of courts of review acting pursuant to the mandates of *Section 19(b)* of the Gas Act, can be resolved only by this Court through its determination of the questions and issues here presented. No natural gas company heretofore has been accorded a full and complete review under the statute of any rate reduction order of the Federal Power Commission. Such circumstance has contributed materially to the presently existing confusion and doubt as to both the public and private rights and duties involved.

The grievous injury and remediless injustice visited upon this petitioner by the order of the Commission and by the judgment of the Court of Appeals herein is manifest from the entire record which is replete with prejudicial error, as follows:

Jurisdiction of the Commission.

The Commission has assumed herein that it is possessed of virtual administrative finality and that it is not required except by generalized ultimate conclusions of reasonableness and propriety to disclose the specific evidentiary and other foundations of its action.

The Commission in its opinion and order herein discarded relevant, uncontroverted and controlling evidence upon is-

sues of material fact; indulged conjecture, guess and speculation in the absence of substantial or any evidence to permit the conclusions announced; failed to make findings of basic and essential facts; cast aside the applicable law and controlling judicial decisions in numerous respects; and generally while adhering to the *forms* of "due process," erroneously has declared both the facts and the law to be in conformity with the non-existent statutory policies and objectives, which it has undertaken to establish. As a result, the Commission action in this case was arbitrary and contrary to law.

Scope of Review.

The Court of Appeals *(R. V. 3, pp. 1323-1339)* under its announced concept that the authority and "broad area of discretion" of the Commission for all practical purposes is without legal restraint and "virtually supreme," and that on review the courts of the land are powerless to afford relief against or examine judicially a rate reduction order of that body even if it is or "appears to be illogical and unfair" or arbitrary, has misapprehended and disregarded both the mandate of the Congress to it embodied in *Section 19(b)* of the Natural Gas Act, the heretofore settled and the present course of authoritative judicial decision and the basic concept of our American structure of government which does not contemplate the "free rein" of unbridled power in the hands of any public officials, be they ever so "expert," as finders of the facts or as expounders of the law.

The Court of Appeals in its opinion and consequent judgment herein has not proceeded under a correct rule of law, by reason of the assertions and assumptions made by it: that the Commission has been given by "the courts," not by Congress, a "free rein," notwithstanding *Section 19(b)* of the Natural Gas Act, but as that section assertedly has been construed by the courts *(R. V. 3, p. 1327)*; that Commission action since it, as it is said, "is the product of 'expert judgment' " is correct as "an almost conclusive presumption" *(R. V. 3, p. 1328)* and that "the administrative judgment has been declared virtually supreme" *(R. V. 3, p. 1339)*. The foregoing mean that the Commission order is immune from judicial review on the facts. Such is not the law.

The Court of Appeals, while patently solicitous lest it "trespass upon the administrative prerogatives" *(R. V. 1, pp. 1327-1328, 1329-1333, 1333-1335, 1335-1336, 1337, 1337-1339)*, clearly was concerned not at all either in recognizing or in performing any duty and function of actual judicial review whatever herein under *Section 19(b)* of the Gas Act. *(Connecticut L. & P. Co. v. Federal Power Comm.*, 324 U.S. 515, 65 S. Ct. 749).

The Court of Appeals, relying on its own assertion that petitioner did not offer evidence as to certain fact issues *(R. V. 3, pp. 1333, 1335, 1337)*, ignored the correct rule of law that in a Commission inquiry as to the reasonableness of rates and charges, the burden of actual proof rests upon the Commission to establish in the rate case the fact of unreasonableness and the amount thereof, before lawfully it may enter any order of rate reduction, and that under the standards of *Section 19(b)* of the Gas Act that burden of proof must have been sustained by "substantial evidence," else the Commission order cannot stand on review.

Rate Regulation of Gas Reserves, Production and Gathering.

The Commission ignored the lawful ambit of its statutory authority herein, by its inclusion of the natural gas rights and leaseholds and other production and gathering properties in the Commission "rate base" of the regulable property and business, contrary to *Section 1(b)* of the Gas Act.

The Court of Appeals *(R. V. 3, pp. 1328-1329)*, in its unsupported conclusion "that under the prevailing view, the Commission did not exceed its jurisdiction by the inclusion of the production and gathering facilities in the rate base * * *", has misconceived the force, effect and decision of this Court in the consolidated cases of *Colorado Interstate Gas Company* and *Canadian River Gas Company v. Federal Power Commission*, 324 U.S. 581, 65 S. Ct. 829, in that no majority of this Court has declared "the prevailing view" thus attributed to it by that Court.

That Court *(R. V. 3, p. 1329)* confused or disregarded the elementary difference in fact, in reason and in consequences,

between "*inquiring into and considering* the production and gathering properties in respect of depreciation, operating expenses and revenues in so far as they had bearing upon the exercise of its jurisdiction to determine just and reasonable rates of natural gas transported interstate for resale for public consumption" and "*reflecting* the production and gathering facilities of a natural gas company *in the rate base* * * *." (Emphasis added.)

The conclusion of that Court *(R. V. 3, p. 1329)* that "The Supreme Court, after review and discussion * * * was of the opinion that it (The Gas Act) did not 'preclude the Commission from reflecting the production and gathering facilities * * * in the rate base * * *' " is not a correct statement of the decision of this Court relied on in that behalf.

Rate Base of Natural Gas Reserves.

The Commission did not follow the correct rule of law (*See Colorado Interstate Gas Co. v. Federal Power Comm.*, 324 U.S. 581, 605, 65 S. Ct. 829, 840 and cases cited) in its determination and conclusion that when, as the Commission found herein, the so-called "actual legitimate cost of the Company's property is accurately ascertainable from the books and records," the Commission is required by *Section 6(a)* of the Gas Act in its fixation of rate base to use "actual legitimate cost" and only actual legitimate cost.

The Commission did not follow a correct rule of law in excluding all evidence of "fair value" as "irrelevant and immaterial" *(R. V. 3, p. 1331)* in its determination of "rate base."

The Court of Appeals *(R. V. 3, pp. 1329-1333)*, in disregard of the law and its mandated duty of review, committed grievous and prejudicial error:

In its refusal *(R. V. 3, p. 1331)*, notwithstanding and "in the face of fundamental considerations of fairness to the contrary," even to examine and test the order of the Commission as measured by the record to determine whether, as stated by this Court, "it is invalid, because it is unjust and unreasonable in its consequences" and produces an "arbitrary result."

In its failure to realize and consider that the Commission "whose duty it is to make 'the pragmatic adjustments called for by the particular circumstances' " *(R. V. 3, p. 1339)* precluded itself entirely from performing that equitable function by declaring, contrary to law, that it (the Commission) is required by *Section 6(a)* of the Natural Gas Act in all cases to exclude from the record all consideration and evidence of "fair value" of the property of petitioner in its rate base determination and thereby also is limited as a matter of law to "actual legitimate cost" as the sole measure of rate base and every element thereof in all cases *(Op. Comm., R. V. 1, pp. 31-33, and cases cited).*

In its assertion *(R. V. 3, p. 1333)* that the "pronouncements" of "the majority" of this Court prohibit all judicial inquiry into the propriety of "including the production properties in the rate base at actual legitimate cost," in this and in every other case.

In its legal conclusion *(R. V. 3, p. 1333)* that the statutory standard of "just and reasonable," as distinguished from "arbitrary" action, is circumscribed and disposed of solely by whether or not the Commission action "results in the impairment of the financial integrity of the company as a public utility."

The conclusion of that Court *(R. V. 3, p. 1333)* that the propriety or impropriety of including the production properties in the rate base at actual legitimate cost is "no longer a debatable question" and thus, as a matter of law, is not reviewable, is an erroneous statement and conclusion of law, and of necessity precluded that Court from any consideration of "pragmatic adjustments," of that which is "just and reasonable" and of the "end result," upon which we are told authoritatively the decision of the reviewing court "in each case must turn."

In its declaration *(R. V. 3, p. 1332)*, "We have not the right to intercede unless it is *conclusively shown* that failure to give consideration to the fair value of the properties, including the valuable leasehold estates, will prevent the company from operating successfully as a public utility." This statement is not supported by the cases cited. Under this

expressed view of that Court, all considerations of unfairness, unreasonableness, arbitrary action, pragmatic adjustments and end result are in reality the sole, absolute and unreviewable prerogatives of the Commission. Such is not the statutory standard of "fair and reasonable" or otherwise the law of this land.

Existing Depreciation and Depletion.

The Commission, in disregard of controlling law, has made basic and essential findings and conclusions herein as to "existing depreciation" which are not supported by evidence and are contrary to the uncontradicted evidence *(R. V. 1, pp. 44, 45-46)*.

The Court of Appeals *(R. V. 3, pp. 1333-1335)* disregarded the fundamental and recently re-declared requirements of law that there must be appropriate and specific findings of fact, that "The findings of the Commission as to the *facts*" must be "supported by *substantial* evidence," and that the courts are not authorized under *Section 19(b)* to make findings and substitute them for those of the Commission, which this Court herein in fact has done.

That Court failed to examine and appraise, under the statutory requirement of "substantial evidence," the sufficiency of the evidence of the one Commission witness on the subject of "depreciation and depletion," to support the Commission's "finding * * * of the facts" and conclusion on that subject. In this connection that Court recited merely the broad, general statements and conclusions of the witness on his direct examination. No notice is given to the factual content and probative value of the free and easy conclusions of that witness or to the actual insufficiencies and inconsistentencies of his testimony developed on his own cross-examination. This conception and action of that Court does violence to the statutory standard, and denies all review in fact of the "finding * * * as to the facts," a duty specifically imposed upon that Court by the Act. The general and specific legal import of "substantial evidence" is not satisfied by such selected and fragmentary excerpts from the testimony of a witness, without regard to his entire testimony and

consideration of the force and effect of his testimony as a whole *(Connecticut L. & P. Co. v. Federal Power Comm.,* 324 U.S. 515, 65 S. Ct. 749).

That Court *(R. V. 3, pp. 1333-1334)* disregarded entirely and, therefore, made no determination whatever of, the substantial issue of "The $2,200,000 erroneously added by Commission 'adjustment' to petitioner's depreciation reserve, as fixed by the Commission" *(R. V. 1, pp. 45-46; R. V. 1, pp. 207-208).*

Natural Gasoline Extraction Operations of Cities Service Oil Company.

The Commission disregarded the controlling law (See *Smith v. Illinois Bell Telephone Co.,* 282 U.S. 133, 144, 151-153, 51 S. Ct. 65, 67, 70; *Section 1(b)* of Gas Act) in expropriating and treating the natural gasoline extraction plants, business and earnings of Cities Service *Oil* Company "as if they belonged to petitioner"; and in treating such plants, business and earnings as though they were subject to the rate-regulatory control of the Commission.

The Court of Appeals *(R. V. 3, pp. 1335-1336)* misapprehended and misapplied the applicable law in approving as a matter of law the Commission action and order treating the natural gasoline extraction plants and business of Cities Service Oil Company "as if they belonged to petitioner."

That Court *(R. V. 3, pp. 1335-1336)* in its passing reference to the Commission so-called "average excess profits for the years 1939 to 1942" of such plants and business, ignored the fact, uncontradicted in the record, that the Commission in its purported ascertainment of such "profits" refused to reflect as a deductible expense Federal income taxes in any amount or at all.

That Court *(R. V. 3, pp. 1335-1336),* consonant with its contention that Commission action is "virtually supreme" and attended with "an almost conclusive presumption" in its favor, concluded, without independent examination of and judicial appraisal of the meaning and import of the record, as measured by the requirement of "substantial evidence," that the Commission conclusions are immune from attack and review as a matter of law.

Federal Income Taxes.

The Commission did not adhere to the correct rule of law (See *Galveston Electric Co. v. Galveston,* 258 U.S. 388, 399, 42 S. Ct. 351, 356) in eliminating all Federal income taxes from "deductible expense," from "Cost of Service" and from "Cost of Service Allocation" *(R. V. 1, p. 57),* and the Court of Appeals committed like error in approving and affirming such Commission elimination of Federal income taxes.

The Court of Appeals *(R. V. 3, p. 1337)* misstated and, therefore, misconceived the so-called "thesis" upon which it is said the Commission proceeded in its denial of all Federal income taxes as an expense deduction in arriving at the over-all net earnings of petitioner for the year 1941, for the purposes of the Commission Federal income tax "adjustment," so-called, *(Comm. Ex. 41, R. V. 3, p. 1264; R. V. 1, p. 57 and note).*

That Court then concluded *(R. V. 3, p. 1337)* that "the petitioner may not charge as an expense that which it cannot lawfully earn," which statement, whether true or false, bears no relation whatever either factually, logically or legally, to the issue of "Federal income taxes" presented in this record.

That Court *(R. V. 3, p. 1337),* contrary to law, assumed and concluded that the Commission lawfully may limit the over-all earnings of this petitioner (described by the Court as "permissible earnings") upon its non-regulable sales and earnings, as well as upon its regulable sales and earnings.

That Court, so far as the opinion discloses, was wholly unaware of the fact, uncontroverted in the record, that all other expenses of both regulable and non-regulable operations and sales, except Federal income taxes, were, as by reason and law required, deducted in the Commission's staff determination of over-all net earnings for Federal income tax purposes. For instance, the "cost" or purchase price of all natural gas sold only in the non-regulable operations was used in the Commission's staff income tax computation to support the Commission conclusion that there was no Federal income tax liability upon "permissible earnings."

In short, and in defiance of law, fairness and decency, all expenses of the non-regulable operations, sales and earnings (both less than and more than 6½%) were utilized to lend color and the badge of propriety to the Commission order that all Federal income taxes must be paid by the "non-jurisdictional sales."

That Court, in the use of the phrases "permissible earnings" *(R. V. 3, p. 1337)* and "permissible return from the adopted rate base" *(R. V. 3, p. 1337; Op. R. V. 1, p. 57, Note)* disclosed a definite misapprehension, prejudicial to this petitioner, of the lawful "prerogatives" of the Commission under the Natural Gas Act, both as enacted and as construed most recently by this Court.

That Court concluded *(R. V. 3, p. 1337)* "We must therefore assume on this record that the Commission's statement • • • is correct" to the effect that it "did no more than allocate to the non-jurisdictional sales the cost of earnings which were solely attributable to it." This conclusion is predicated upon the assertion by that Court that petitioner "offers no affirmative computation tending to show its tax liability upon the permissible rate." The conclusion of that Court is not in conformity with law, and its assertion is not conformable to fact.

Allocation of Cost of Service.

The Commission, as disclosed by its conclusions herein *(R. V. 1, pp. 59, 61)*, did not give consideration as to whether properly to make allocation between the regulated business and the unregulated business, a separate allocation of plant, property and earnings should have been made; did not make "basic and essential findings" by which "the path which it followed can be discerned"; and did not reflect in its "allocation of cost of service," so-called, substantial items which properly and lawfully should have been incorporated therein *(R. V. 1, pp. 55, 57)*.

The Court of Appeals *(R. V. 3, pp. 1337-1339)* made some descriptive recital of the Commission so-called "demand and commodity" method of "allocation of cost of service," and thereafter set out several short quotations from various opinions of this Court, including from the opinion of Mr.

Justice Douglas in the consolidated *Colorado Interstate Gas Company* and *Canadian River Gas Company* cases, the following: "The appropriateness of the formula raises questions of fact, not of law," but that Court did not quote from the same opinion the further statement that "Considerations of fairness, not mere mathematics, govern the allocation of costs." The Court of Appeals then concluded that since "the administrative judgment has been declared virtually supreme"—"we shall not criticize that which we are powerless to correct. * * * We cannot say on this record that the application of the formula is so wholly unrelated to the facts as to produce an illegal or reversible result." Thus, without respect to or differentiation between the general "method" or "formula" adopted and the actual detailed pattern imposed, without notice of or regard to "considerations of fairness," and additionally in derogation of the admitted statutory standard of "substantial evidence" applicable alike to all and every finding * * as to the facts," that Court, in its willing retreat from fancied "trespass upon the administrative prerogatives" refused even to enter into any process of actual review herein, on the assigned ground that lawfully it may not so do. Such is not the law.

That Court *(R. V. 3, p. 1339)* apparently assumed, but did not decide, as related to the facts and circumstances of this case, that the Commission "allocation of cost of service is a fundamentally correct and permissible method of effecting a separation of the regulable from the non-regulable sales," operations and properties. This petitioner, as of right, is entitled to a judicial determination of this issue.

That Court *(R. V. 3, p. 1339)* considered the problem of "allocation of cost of service" to be an "economic one," as well as one of engineering, to be resolved by "experts" through "the exercise of informed judgment" in such manner as is "reasonable in view of the particular operations and circumstances of the system in each case." *Nevertheless, that Court refused to examine or consider the evidentiary foundations and propriety of the determination of the "economic" and other relevant factors by the sole Commission staff witness on that subject.* Further, that Court neglected to examine the qualifications of that witness and the

reasonable basis for his unsupported conclusions in support of the actual frame-work of the so-called "allocation" herein. This witness testified that he had never before prepared such a "cost allocation" *(R. V. 1, p. 825)*, although, according to that same witness, as quoted by that Court, the problem is one of such difficulty "that engineers and economists have been studying for many years" upon it. Real review under *Section 19(b)* of the Act, predicated upon the record herein filed as required by law, lawfully may not be denied.

End Result and Due Process.

Due process which has been described in this Court as "the rudiments of fair play" finds expression in the declaration of this Court that:

> "* * * Once a fair hearing has been given, *proper findings made* and other statutory requirements satisfied, the courts cannot intervene in the absence of a clear showing that the limits of due process have been overstepped. *If the Commission's order, as applied to the facts before it and viewed in its entirety, produces no arbitrary result, our inquiry is at an end.*" (Emphasis added.)
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> *Federal Power Comm. v. Natural Gas Pipeline Co.*, 315 U.S. 575, 586, 62 S. Ct. 736, 743.

The Commission and Court of Appeals alike failed and refused herein to examine, consider and determine in fact whether the Commission "cost" rate base reduction order was fair and reasonable or produced an "arbitrary result." The Commission precluded itself from such inquiry under its erroneous view of the law that "cost" and cost alone is the only lawful measure of rate base. The Court of Appeals simply refused to make such inquiry.

The Court of Appeals in its opinion and judgment in affirmation of the Commission order has denied in fact and in effect to this petitioner "due process" of law under established, ordered and orderly processes of American government, and particularly the Natural Gas Act and the Fifth Amendment to the Constitution, in that, under the theory of "administrative finality" and "judicial impotency," the Commission determinations of (1) jurisdiction, (2) the man-

ner of exercise thereof, (3) basic material facts, (4) findings and ultimate conclusions, and (5) controlling principles and rules of law, are held by that Court to be immune from the express statutory judicial supervision, examination and review accorded and commanded.

CONCLUSION.

In consequence of the foregoing matters, facts and reasons, more fully considered in the attached memorandum brief, it is submitted, respectfully, that this petition for writ of certiorari should be granted.

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MEMORANDUM BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

The foregoing petition for writ of certiorari is addressed to basic conceptions and procedures entertained and followed by the Federal Power Commission and the Court of Appeals herein, in misapprehension or disregard of the facts of this record and the applicable and controlling rules and principles of law. The resulting injuries to this petitioner are great and irreparable.

So far as is possible, this brief discussion will conform in outline to the various subject titles as set forth in "Questions Presented," *supra.*

Administrative Jurisdiction of the Commission and Scope of Review.

It is perfectly clear, from the first subdivision of the opinion of the Court of Appeals, entitled "Jurisdiction of the Commission and Scope of Review"*(R. V. 3, pp. 1327-1328),* that that Court envisioned itself as completely impotent in the face of the "virtually supreme" and unlimited "administrative prerogatives," declared to be possessed by the Commission, and that all issues would be disposed of accordingly, as was done. Thereafter and similarly, all questions of law involving the meaning or judicial construction of the Natural Gas Act were disposed of summarily. Here again the end result of this review was obvious in advance because of the disclosed background philosophy of the Court of Appeals.

The opinion basically is a reiteration of the statements, contentions, arguments and conclusions of the Commission and its staff. It is interspersed, however, with catch phrases, hasty and faulty rationalizations and selected sentence quotes from some of the numerous but divergent concurring opinions in recent decisions of this Court. In several instances, such quotations do not reflect any majority of this Court, and, removed from the setting in which they were uttered and reflecting but part of the thought or idea intended by the authoring Justice, are without legal or judicial significance or as used are in fact misleading. The

foregoing characteristics of the opinion of the Court of Appeals will be considered with particularity later herein.

The opinion throughout manifests that its foundations were laid and the structure thereof developed in the mold of the philosophy of the uncontrolled and uncontrollable supremacy of the executive and administrative branch of the Federal government over the constitutionally coordinate legislative and judicial branches thereof. Whatever language of explanation or extenuation is suggested by that Court, the stern fact remains that that Court has refused to discharge its own obligation of review in accordance with law.

That the scope of review embodied in *Section 19(b)* of the Gas Act is limited, is not questioned. Such is the law. But that the statutory right of review provided is virtually nonexistent in fact, is not the law.[8] The participation of any court in the emasculation of the statutory review carries an implication that the Congress practiced legislative deception and indulged in sophistry in the enactment of the review section.

The phrases "free rein," "broad area of discretion," "expert judgment," "informed judgment," "almost conclusive presumption," etc., etc., do not resolve the issue. Nor is the issue met by such exculpatory assertions as the following: "We are unable to say, as a matter of law, that the Commission's findings on this technical point are legally erroneous" *(R. V. 3, p. 1336)*, or "If some of the specific allocations appear to be illogical and unfair, they necessarily pose technological problems of accounting and finance, upon which the administrative judgment has been declared virtually supreme" *(R. V. 3, p. 1339)*. Since when have the courts been privileged or permitted to abdicate their judicial functions of review because the questions involved are "technical" or "technological"?

After all, Congress in enacting *Section 19(b)* of the Gas Act, which is precisely the same review afforded an ag-

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[8]Colorado-Wyoming Gas Co. v. Federal Power Comm., 324 U. S. 626, 65 S. Ct. 850;
Connecticut L. & P. Co. v. Federal Power Comm., 324 U. S. 515, 65 S. Ct. 749.

grieved party under several other Federal administrative and regulatory Acts, contemplated and expected as in other cases, that such a far-reaching law as the Natural Gas Act would be administered by "experts" of "informed judgment," who as administrators would have a "broad area of discretion."[9] Nevertheless, the Congress thereupon deliberately incorporated *Section 19(b)* into the Act. Nor is it suggested by that Court that Congress did not know its intentions and the import of its enactment in that behalf.

The Court of Appeals, at the outset of its brief discussion of "scope of review" refers to a statement by Mr. Justice Douglas in the *Hope Natural Gas Company* case (320 U.S. 591, 610), to the effect: "The primary aim of the Natural Gas Act of 1938 was to 'protect consumers against exploitation at the hands of natural gas companies'" *(R. V. 3, p. 1327)*. Whatever may be said for the views of Mr. Justice Douglas in the setting and in connection with the matter then under discussion by him, which was not "scope of re-

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[9]See Federal Power Act, Holding Company Act of 1935, Communications Act of 1934, National Labor Relations Act, Motor Carrier Act, Radio Act of 1927, Interstate Commerce Act, Railway Labor Act, Packers and Stockyards Act, as well as the Natural Gas Act. Under each of these Acts administrative orders entered by those presumed to be "expert" of "informed judgment" and having a "broad area of discretion," nevertheless were set aside by the courts because the findings or conclusions of the Commission or Board were insufficient or were not "supported by substantial evidence." In each instance the reviewing court made an independent examination and appraisal of the record evidence.

Connecticut L. & P. Co. v. Federal Power Comm., 324 U. S. 515, 65 S. Ct. 749;
Securities & Exchange Comm. v. Chenery Corp., 317 U. S. 80, 63 S. Ct. 454;
Saginaw Broadcasting Co. v. Federal Power Comm. (C.C.A., D.C.), 96 Fed. (2d) 554 (Certiorari denied.);
Consolidated Edison Co. v. National Labor Relations Board, 305 U. S. 197, 59 S. Ct. 206;
National Labor Relations Board v. Columbian, etc. Co., 306 U. S. 292, 59 S. Ct. 501;
Eastern Central M. C. Ass'n. v. U. S., 321 U. S. 194, 64 S. Ct. 499;
Federal Radio Comm. v. Nelson Brothers Co., 289 U. S. 266, 53 S. Ct. 627;
Interstate Com. Comm. v. Jersey City, 322 U. S. 503, 64 S. Ct. 1129;
Shields v. Utah-Idaho Cent. R. Co., 305 U. S. 177, 59 S. Ct. 160;
St. Joseph Stock Yards Co. v. United States, 298 U. S. 38, 51, 74-75, 56 S. Ct. 720;
Colorado-Wyoming Gas Co. v. Federal Power Comm., 324 U. S. 626, 65 S. Ct. 850.

view," is not here material. However it is not a judicial utterance as used by the Court of Appeals in its discussion. If the asserted "aim" was in fact "the primary aim of the Natural Gas Act," Congress most certainly was fully aware of that fact before and at the time of the enactment thereof. Nevertheless, the Congress thereupon deliberately incorporated *Section 19(b)* into the Act.

This section as enacted is available alike to the Commission or a "natural gas company." It is also available to a "natural gas company" whether or not that company is or has been guilty of "exploitation," so-called. And how, we ask, without review, could that Court, or any other court, determine guilt or innocence in the particular case, and if guilty, how could that guilt foreclose review under *Section 19(b)*? Under our system both the innocent and the guilty have legal rights. Moreover, it is inconceivable that Congress intended, or that the law permits, any court to enlarge or reduce at will the scope of review to be accorded by it under *Section 19(b)*, dependent upon its conclusion or guess as to guilt or innocence of "exploitation." Such is not the structure of our legal and governmental institutions, nor the proper or lawful manner of other administration. Thus, the quoted statement here relied upon by that Court cannot have any possible relation to or bearing upon the scope of the directed statutory review. Yet it influenced that Court, else it would not have been incorporated into its discussion of this subject. The idea seems to be that every "natural gas company" is guilty of "exploitation" and, therefore, no "natural gas company" has the right of orderly review, *Section 19(b)* of the Act to the contrary notwithstanding. Such a conception of the law is erroneous, dangerous and highly prejudicial.

The mandate of *Section 19(b)* of the Act is clear. It has not been obscured or sterilized by any pronouncement of the majority of this Court. It is still the law that courts of review, in discharge of their statutory responsibility and obligation, have express jurisdiction and are directed, notwithstanding whatever presumptions of validity properly

may attend the order,[10] to "modify or set aside * * * in whole or in part" any order of the Commission in excess of its statutory jurisdiction, or entered when that body "has not proceeded under a correct rule of law," or if the order does not contain "the basic or essential findings upon which administrative orders rest," or if the findings in the order are not "supported by substantial evidence,"[11] or if the end result is "arbitrary," "unjust and unreasonable," or does not reflect the "pragmatic adjustments called for by the particular circumstances." Administrative agencies are not

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[10]It is true that on review the Commission order "carries with it a presumption of correctness" (*Colorado Interstate Gas Co. v. Federal Power Comm.*, 142 Fed. (2d) 943, 954) and that "informed and expert judgment exacts and receives a proper deference from courts" (*Ohio Bell Tel. Co. v. Public Utilities Comm.*, 301 U. S. 292, 304, 57 S. Ct. 724, 730).

It was said by Mr. Justice Douglas in *Federal Power Comm. v. Hope Natural Gas Co.*, 320 U. S. 591, 602, 64 S. Ct. 281, 288: "Moreover the Commission's order does not become suspect by reason of the fact that it is challenged. It is the product of expert judgment which carries a presumption of validity. And he who would upset the rate order under the Act carries the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences" (assuming of course "a fair hearing has been given, proper findings made and other statutory requirements satisfied," *Natural Gas Pipeline* and *Colorado-Wyoming Gas Company* cases, *supra*).

But it cannot be contended with propriety that Congress, in providing for limited review herein along standardized lines, intended that the grant of authority should be hamstrung by application of presumption after presumption of such bulk and character as to predetermine the result before the judicial inquiry is launched, although such presently is the "end result" in this case under the opinion of the Court of Appeals.

To attribute such an intent is in effect to draw in question the good faith of Congress and to convey also the suggestion that the courts are expected to collaborate in such a sinister design.

[11]This Court repeatedly has defined and delineated with particularity the meaning and application of the term "substantial evidence" as "such relevant evidence as a reasonable mind might accept as adequate to support a conclusion"; "it must be enough to justify, if the trial were to a jury, a refusal to direct a verdict * * *"; "evidence which is substantial, that is, affording a substantial basis of fact from which the fact in issue can be reasonably inferred." The desirable freedom from the technical rules of evidence "does not go so far as to justify orders without a basis in evidence having rational probative force" (*Consolidated Edison Co. v. National Labor Relations Board, supra, National Labor Relations Board v. Columbian, etc. Co., supra, Connecticut L. & P. Co., v. Federal Power Comm., supra*).

The requirement of specific findings as to basic and essential facts as a condition of the exercise of power possessed is of no avail, if inadequate, insufficient or unsupportable fact determinations are so sacrosanct that judicial inquiry is precluded as a "trespass upon the administrative prerogatives (*Colorado-Wyoming Gas Company case, supra*).

"virtually supreme," Congress lawfully may not be excluded from its legislative "prerogatives," even by indirection, and courts of review are not impotent to supervise, examine, modify or set aside administrative determinations as by law directed.[12]

The Court of Appeals, in making its broad generalizations as to the finality of administrative findings, overlooked completely the recent case of *Connecticut L. & P. Co. v. Federal Power Commission*, 324 U.S. 515, 65 S. Ct. 749, in which the decision of this Court was made by a clear majority. In the *Connecticut* case this Court, among other things, launched upon and made an independent review, that is a "re-view," of the facts to test the sufficiency of the evidence, under the standard of "substantial evidence," to support the Commission findings. Certain determinations and conclusions of the Commission were held not tenable, in large part because, as stated by this Court, of the fact to which the Commission apparently gave no weight, "that the predominant characteristics of the company's over-all operation is that of a local and intrastate service." The review there was under *Section 313(b)* of the Federal Power Act, which is identical with *Section 19(b)* of the Natural Gas Act. The decision here is not consistent with the decision there.

Thus the reviewing court, without a true review, lawfully may not make final the fact findings of the Commission. Nor is the judicial determination to be weighted in favor of the Commission so that the reviewing court is compelled to see the problem only through the Commission's "expert" eyes. This the *Connecticut* case discloses.

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[12]Natural Gas Pipeline Co. v. Federal Power Comm., 315 U. S. 575, 62 S. Ct. 736;
Canadian River Gas Co. v. Federal Power Comm., 324 U. S. 581, 65 S. Ct. 829;
Connecticut L. & P. Co. v. Federal Power Comm., 324 U. S. 515, 65 S. Ct. 749;
Colorado-Wyoming Gas Co. v. Federal Power Comm., 324 U. S. 629, 65 S. Ct. 850.

Regulation of Producing and Gathering of Natural Gas.

The Court of Appeals readily disposed of this very substantial question and with extraordinary brevity. It concluded that, despite *Section 1(b)* of the Gas Act, the Commission had full and *complete regulatory authority* to include petitioner's producing and gathering properties in the Commission rate base. It is said objection thereto "has already been squarely met and conclusively decided" against the petitioner "in the *Colorado Interstate Gas* case," adding that "On certiorari, the Supreme Court, after review and discussion" was of such opinion and so "It is thus clear under the prevailing view the Commission did not exceed its jurisdiction by the inclusion * * *." No attempt or even gesture is made to examine and appraise the legal force and effect of the decision in the *Canadian River Gas Company* case in question.

That Court was unmindful of or unimpressed with the fact that Mr. Justice Douglas, speaking for himself and Justices Black, Murphy and Rutledge only, a minority of this Court, announced the view described by the Court of Appeals as "the prevailing view." Mr. Justice Jackson concurred "in upholding" the Commission action and order but did not concur in the judicial repeal or nullification of *Section 1(b)* of the Act, undertaken by Mr. Justice Douglas and his associates. On the contrary, Mr. Justice Jackson insisted that the Commission by its action had simply taken "evidence as to conditions and events quite beyond its regulatory jurisdiction where they were thought to affect the cost of that whose price it is directed to determine. This as I see it is all that has been done here." This is a plain denial of Commission regulatory authority over production and gathering.[13] The late Mr. Chief Justice Stone, for him-

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[13]The prohibition of *Section 1(b)* of the Gas Act is clear and unambiguous to those seeking to determine and conform to the scope of and the limitations imposed upon the structure of Federal regulatory control embodied therein.

Both the "shall not" and the "shall" provisions of the Act mean precisely what Congress said by the words used. "Shall not" does not mean "shall." "Shall" does not mean "shall not."

self and Justices Roberts, Reed and Frankfurter, declared that the Commission had disregarded "the plain command of *Section 1(b)* excluding the production or gathering of gas" from the regulatory jurisdiction of the Commission. Here then are three views, but no majority of this Court agreed that the Commission had regulatory authority over the producing and gathering of natural gas.

This Court, through Mr. Justice Douglas then speaking for a majority of the Court, recently decided and declared:

In the *Connecticut Light and Power Company* case, supra, the majority of this Court, construing and applying the analogous and virtually identical provisions of the Federal Power Act, and speaking through Mr. Justice Jackson, emphatically repudiated the Commission inversion of the language of the Act.

Referring particularly to *Section 201(b)* of the Power Act, which parallels *Section 1(b)* of the Gas Act, this Court therein declared:

> "It is hard for us to believe that Congress meant us to read 'shall have jurisdiction' where it had carefully written 'but shall not have jurisdiction.' The command 'thou shall not' is usually rendered as to forbid and we think here it was employed without subtlety or contortion and in its usual sense."
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> *Connecticut L. & P. Co. v. Federal Power Comm.*, 324 U. S. 515, 528-529, 65 S. Ct. 749, 755.

"It is hard for us to believe" that Mr. Justice Jackson, who used the foregoing language on one Monday (March 26, 1945) in the *Connecticut L. & P. Company* case, meant,—on the following Monday (April 2, 1945) in the *Canadian River Gas Company* case (324 U. S. 581, 65 S. Ct. 829, 842) by his unambiguous statement "It is true that the Act excludes 'production or gathering of natural gas' from the jurisdiction of the Commission. If the Commission had imposed any direct regulation upon that activity, I would join in holding it to have exceeded its jurisdiction,"—to declare, contrary to the "usual sense" of his words "employed without subtlety or contortion," that the Commission did have "regulatory jurisdiction" over "production or gathering of natural gas." Such conclusion was asserted and announced only by and for the minority for which Mr. Justice Douglas spoke in that case. Nevertheless the Court of Appeals in its opinion herein simply assumed as a fact, but contrary to the fact, that such also was the position of Mr. Justice Jackson. Otherwise there could be no majority and no authoritative decision. Having made the assumption, the Court of Appeals summarily and easily disposed of the jurisdictional issue of "regulation of producing and gathering of natural gas" by reliance upon its own inaccurate catch phrase, "the prevailing view" (*R. V. 3, p. 133*).

"It is hard for us to believe" also, on the basis of fact, of reason and of candor, that on review the statutory provision, "Upon the filing of such transcript such court *shall have* exclusive jurisdiction to affirm, modify or set aside such order in whole or in part" (*Sec. 19(b)*), means that the reviewing court "shall not have" jurisdiction so to do, contrary to the "usual sense" of the statutory language, "employed without subtlety or contortion," declaring expressly the standards of review under the Act. Nevertheless the Court of Appeals so has held herein.

"* * * the lack of an agreement by a majority of the Court on the principles of law involved prevents it (the decision) from being an authoritative determination for other cases" *(United States v. Pink*, 315 U.S. 203, 216, 62 S. Ct. 552, 558).

The divergent minority views expressed in the *Canadian River Gas Company* case, and the force and declared legal effect of such minority expressions of opinion, therefore certainly could not justify the cavalier assertion by the Court of Appeals that the question had been "conclusively decided."

Upon one principle of law this Court, except Mr. Justice Jackson, did agree, however, that the inclusion of the production and gathering properties *in the Commission rate base* constituted the exercise of direct regulatory authority over such properties and not a mere inquiry into and consideration of production costs. *Canadian River Gas Co. v. Federal Power Comm.*, 324 U.S. 581, 597-604, 615-625; 65 S. Ct. 829, 837-840, 845-850). Such determination, therefore, is "authoritative," *(United States v. Pink, supra).*

In any event this Court has not made "an authoritative determination" or "conclusively decided" that the Commission lawfully can include the producing and gathering properties of a "natural gas company" in the Commission "rate base." This issue, the Court of Appeals evaded and did not meet and decide judicially *(R. V. 3, p. 1333).*

Rate Base of Natural Gas Reserves.

The Commission excluded all evidence of "fair value" on the asserted rule of law that "actual cost was accurately ascertainable from the books and records of the Company," and, therefore, it was commanded by *Section 6(a)* of the Natural Gas Act to confine itself to such cost and was prohibited from considering "fair value" for rate base purposes *(R. V. 1, pp. 31-32).* "No such rule of law has been laid down" in the Gas Act or by this Court.

This Court repeatedly has declared, through both majorities and minorities, that "Congress, however, has provided no formula" and "that the Commission was not bound by

the use of any single formula or combination of formulas." No decision of this Court is authority for or even suggests the rule of law imposed by the Commission upon itself that it is directed to fix natural gas rates by exclusive application of the "prudent investment" or "actual legitimate cost" rate base theory.

Federal Power Comm. v. Natural Gas Pipeline Co., 315 U.S. 575, 62 S. Ct. 736;
Federal Power Comm. v. Hope Natural Gas Co., 320 U.S. 591, 64 S. Ct. 281;
Canadian River Gas Co. v. Federal Power Comm., 324 U.S. 581, 65 S. Ct. 829.

The Commission, therefore, "has not proceeded under a correct rule of law" and "it follows" that its order "must be reversed."

Connecticut L. & P. Co. v. Federal Power Comm., 324 U.S. 515, 65 S. Ct. 749.

The Court of Appeals *(R. V. 3, pp. 1329-1333)* ignored entirely this aspect of the legal impropriety of the Commission's action in refusing to consider evidence of "fair value." And whether or not the Commission would have reached the same conclusion as to rate base, aside from such erroneous view of the law, is idle speculation and wholly immaterial *(Connecticut L. & P. Co. v. Federal Power Comm., supra)*. Notice must be taken of the fact that the review sections of the companion Federal Power and Natural Gas Acts are identical. The *Connecticut* case is an "authoritative" command to that Court.

A further consequence of the failure of the Commission to proceed "under a correct rule of law" is that the rigid and "erroneous view of the law," which it did adopt, preclude it "whose duty it is" from making any "pragmatic adjustments" which otherwise might be "called for by the particular circumstances" *(R. V. 3, p. 1339)*.

To consider the facts relevant to the making or withholding of "the pragmatic adjustments which may be called for by particular circumstances" *(Natural Gas Pipeline Company* case, 315 U.S. 575, 586, 62 S. Ct. 736, 743) is one thing. But to hold that the proof of "fair value" *(See Sec.*

6(a) of Gas Act) presented in support of the right to a modification of or substitution for the fixed "cost" rule, as applied to the rate base of natural gas reserves, to satisfy the requirement of a fair and reasonable result, is totally irrelevant, is quite something else. The making of pragmatic adjustments cannot be in the realm of mere administrative benevolence or liberality, as is the established Commission viewpoint. Thereby the disfavored claimant would be without the right even to question in the courts the claimed abuse of "administrative prerogatives." Such a doctrine of administrative finality appears to be that of "absolutism pure and simple." Such is not our structure of government.

Here, whether the correction of the grave injury and injustice to this petitioner, resulting from the application of the "cost" formula to the rate base of the natural gas leaseholds and reserves, is to be made, as directly unlawful or is to be made as a "pragmatic adjustment called for by the particular circumstances" to avoid an "arbitrary result," in any event the Commission has abused and exceeded its authority and discretion. The "end result" in this case of the Commission "cost" formula is grossly unfair, unsupportable and irrational. It is arbitrary and capricious by every standard.

The Commission conclusion or so-called "finding" that its "cost" rate base was "reasonable" *(R. V. 1, p. 50)* is mere words. If, as the Commission erroneously assumed, it was required by law to use and only to use "cost," there remained no area of discretion whatever as to whether the rigid cost formula was "just and reasonable" or "arbitrary." The Commission thus did not permit itself to consider any facts and circumstances other than "cost" and so there could be but one "end result." Such is not the law, as any real examination of the recent decisions of the Supreme Court above referred to will disclose.

The Court of Appeals *(R. V. 3, pp. 1332-1333)*, in its appraisal of the *Canadian River Gas Company* case (324 U.S. 581) upon the issue of the legality of including the gas-producing properties of that Company in the rate base "at their nominal cost" to the total exclusion of the con-

cept and fact of the "value" thereof, stated: "That point was taken on certiorari, 323 U.S. 807, and specifically treated on appeal, 324 U.S. 604. The majority of the Court could not 'say as a matter of law that the Commission erred in including the production properties in the rate base at actual legitimate cost.'" Such is not the case. The facts, which cannot be stilled, are that no "majority" approved the statement herein attributed to it. That statement reflected the views of four Justices only. The concurrence by Mr. Justice Jackson in affirming the Commission order cannot possibly be twisted into approval or acceptance of the Douglas-Black-Murphy-Rutledge theory. The views of Mr. Justice Jackson were emphatic and divergent from and hostile to the stated concept of Mr. Justice Douglas, both on principles of law and morality, as were the conclusions of the remaining four Justices.

Moreover, the language quoted by the Court of Appeals *(R. V. 3, pp. 1332-1333)* is but a part of what was said by Mr. Justice Douglas upon the precise question here under discussion, and as a part only it is misleading. As quoted, it carries a conclusion definitely inconsistent with what was said by the Justice, which was:

> "Hence, we cannot say as a matter of law that the Commission erred in including the production properties in the rate base at actual legitimate cost. *That could be determined only on consideration of the end result of the rate order, a question not here under the limited review granted the case.*" (324 U.S. at p. 604.)

The emphasized portion of the foregoing paragraph was omitted from the quote by the Court of Appeals. In its absence that Court concluded "In view of these pronouncements, we regard the question no longer a debatable one in this court" *(R. V. 3, p. 1333)*.

The paragraph must be examined in its entirety. Obviously the second sentence is the explanation of the "why" of the first sentence. The "why" is that this Court could not decide the question at all, because of the limited review granted in the *Canadian* case.

The assertion of the Court of Appeals that the question was decided in the *Canadian* case and adversely to the contention of this petitioner, thus is without foundation.

That Court, in its effort to justify the Commission in exercising the power of decision untrammeled by judicial interference or "notions" *(R. V. 3, p. 1327)* presents the views of Justices Murphy, Black and Douglas *(Natural Gas Pipeline Company* case, 315 U.S. 575, 606) to the effect that "the economic merits of a rate base is of no judicial concern" *(R. V. 3, p. 1332)*.

The opinion in question was one of special concurrence and was not a decision of this Court. The three Judges, in developing their thesis, cited with approval the definition of Mr. Justice Brandeis in *Missouri, ex rel. S.W. Bell Tel. Co. v. Public Service Commission,* 262 U.S. 291, 43 S. Ct. 547, to the effect that the investor interest is adequately served if the utility is allowed the opportunity to earn the cost of the service. That cost was defined by Mr. Justice Brandeis, as follows:

> "Cost includes not only operating expenses, but also capital charges. Capital charges cover the allowance, by way of interest, for the use of the capital, whatever the nature of the security issued therefor, the allowance for risk incurred, and enough more to attract capital * * *."

Such are the criteria of judgment of the jurist whose pronouncements were relied upon, as well as the requirements of the Natural Gas Act.

Mr. Justice Brandeis fully recognized these investor interests and rights, and insisted that they be protected. They are economic in nature. How else could they be classified?

Thus, when the Court of Appeals declared it has "no judicial concern" with "the economic merits of a rate base," which means that a clear property right is to be totally discarded, it amounts to a categorical abjuring of the very function that Court is expected and required to perform. It is basic that the reviewing court remains free to draw the ultimate conclusion dictated by reason and logic. Any real test of due process is a test of reasonableness.

The statutory command directed to the Commission is to determine the "just and reasonable rate," that is, "just and reasonable" to consumer and investor alike *(Secs. 4(a) and 4(e), Gas Act)*. On review and in conformity with the standard of the Act, the reviewing Court likewise is directed to register its independent judgment as to the propriety of the Commission conclusion of "just and reasonable" and of "the facts" upon which that conclusion is predicated. Otherwise, the right of review is a mere prefunctory validation of the Commission's order.

So, it is the inescapable duty of the reviewing court to determine whether it is consonant with fair and reasonable action to exclude as a matter of law from the adjudication of justness and reasonableness enjoined by the statute, *all* consideration of the very great value admittedly inherent in the natural gas leasehold estates herein involved.

Such leaseholds of petitioner, to all intents and purposes, are eliminated from the property account under the Commission "cost" theory. No such result was contemplated by Mr. Justice Brandeis, when he declared that the use of capital must be compensated, and likewise the risk incurred, and enough more to attract capital.

"Devaluation," brought about by the non-reviewable elimination of an essential right of property from the allowance of compensation, obviously is in opposition to the requirement of constitutional due process that a fair opportunity be given for submitting the issue to a judicial tribunal for its independent judgment and determination.

Nowhere in the opinion of the Court of Appeals is there to be found a conclusion or expression of view on the subject of justness and reasonableness. That is to say it does not appear from the opinion whether that Court was convinced that there is actual and sufficient support in fact, in reason and in fairness for the elimination and destruction of the very great and valuable property rights involved *(R. V. 3, p. 1331)*. The Commission result is permitted to prevail because of the abounding and conclusive presumptions which that Court erects to obstruct its own judicial path. Such

presumptions sanction any imaginable action that the Commission might choose to indulge.

The dogma that courts are not concerned with the economics of a rate base cannot be carried to the length that a clear right of property may be expropriated because a mere question of economics is involved. The injunction of the Act to the courts equally with that to the Commission is to so discharge its functions that the result is fair and reasonable to consumer and investor alike.

The Court of Appeals *(R. V. 3, p. 1333)* in conclusion complained that "petitioner has offered no evidence from which we would be justified in concluding that the failure of the Commission to base the allowable return upon the fair value of the leaseholds"—or even to consider the fair value of such leaseholds—"results in the impairment of the financial integrity of the company as a public utility."

The viewpoint of that Court obviously was that it was immaterial whether "the reasonable rate base" *finding* of the Commission was supported by the evidence or fair and reasonable because the burden in the hearing before the Commission and throughout the case was on petitioner to establish by evidence that the Commission determination was unfair, unreasonable and arbitrary.

It is asked how, under the rigid and erroneous rule of law adopted by the Commission, could the question of "impairment" be material or evidence thereof be admissible at all? Moreover, how could it be determined whether there had been or had not been such "impairment" without evidence and knowledge of values? Also, since the Commission action and the disposition therein of the manifold matters of fact and questions of law could not be known until after the close of the case and the entry of its order of rate reduction, just how could this petitioner thereafter offer evidence of "impairment" and secure the incorporation thereof in the record herein? These questions pose problems which, in view of its complaint, that Court of necessity should have faced, but which it did not face or apparently even apprehend.

The law, as declared by this Court is:

"Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the *pragmatic adjustments which may be called for by particular circumstances.* Once a fair hearing has been given, *proper findings made* and other statutory requirements satisfied, the courts cannot intervene in the absence of a clear showing that the limits of due process have been over-stepped. *If the Commission's order, as applied to the facts before it and viewed in its entirety, produces no arbitrary result, our inquiry is at an end.*" (Emphasis added.)

Federal Power Comm. v. Natural Gas Pipeline Co., 315 U.S. 575, 586, 62 S. Ct. 736, 743.

Neither the Commission nor the Court of Appeals evidenced regard for or adherence to this rule of law, presently controlling. The Commission, after declaring its incapacity to do otherwise *(R. V. 1, pp. 31-32)*, nevertheless made the futile gesture of an "ultimate finding" that its rigid cost rate base was "reasonable" *(R. V. 1, p. 50)*. That was the end of the matter so far as the Commission was concerned. The Court of Appeals attempted to dispose of the matter on the ground that, unless "it is conclusively shown" that the Commission order does destroy the petitioner, there is no basis whatever for relief *(R. V. 3, p. 1332)*. This is not the law. It is not fair. It is not decent. It is, therefore, arbitrary. That which is fair, reasonable and decent, as contrasted with that which is arbitrary, easily is measured by resort to the spirit and structure of our society and the "common sense of mankind."

The application of the Commission "cost" theory of rate base to the natural gas rights and leaseholds of this petitioner produces weird, wild, fantastic, illogical, senseless, unfair and totally arbitrary results.

Natural gas produced by petitioner does not enter into the Commission computations either at value, field price, or as a commodity at all. It was not treated *in any respect* the same as purchased gas, *simply because petitioner produced it.*

The Commission "cost" theory produced the following amazing consequences *with respect to current production and deliveries* of gas by petitioner to its customers in 1941:

$.048 per M.c.f. was the current open field price of purchased gas by petitioner in 1941. This price included cost of production, depletion, depreciation and return.

$.02 per M.c.f. ($.0202 per M.c.f. less $.00201 per M.c.f.) was the total production "cost" to petitioner *excluding return on gas reserves,* of all produced gas in the same year.

Nothing, except expense of production, was allowed for gas produced from two-thirds of petitioner's productive reserves in the Texas Panhandle field (28,081,742 M.c.f.). Thus this gas is given away.

$.0023 per M.c.f., plus expense of production, was allowed for gas produced from the remaining one-third of petitioner's productive reserves in that field (14,040,871 M.c.f.).

$.031 per M.c.f., plus expense of production, was allowed for gas produced in the expiring Kansas and Oklahoma fields (1,029,157 M.c.f.).

$.00201 per M.c.f., plus expense of production, was the average allowance for all gas produced and delivered by petitioner in that year.

With respect to the Commission "cost" rate base the results equally are inexplicable:

$.00028 per M.c.f. for the vast gas reserves in the Texas Panhandle and Hugoton fields (3,455,882,921 M.c.f.).

$.114 per M.c.f. ($.10427 per M.c.f., as depleted by the Commission) for the then expiring reserves in the other Kansas-Oklahoma fields (4,794,964 M.c.f.).

See dissenting opinion, Judge Phillips *(R. V. 3, pp. 1342-1346)*, Summary Statement, *supra.*

The foregoing figures manifest beyond peradventure the utter inapplicability of the Commission "cost" theory to the annual production and rate base of natural gas reserves. The fixation of rate base on the criterion of nominal cost of natural gas rights and leases is unreasonable and arbitrary.

The Court of Appeals avoided comment and decision upon these nonsensical and illogical results by disclaiming any "judicial concern" in what it described as "the economic merits of a rate base." The foundation of this disclaimer is not the law. Under any and every accepted standard of thinking and reason, the result is in fact arbitrary. That which is not reasonable is arbitrary. If the Commission result here is not arbitrary, it is impossible to conjure up circumstances under which its action could be found to be arbitrary.

Under the views of that Court, every Commission conclusion is so protected by presumption piled on presumption that it is final if not so wide of the mark as to be irrational as well as arbitrary. Such dogma means that the result of the statutory review, notwithstanding the standard of "substantial evidence" and notwithstanding the requirement that on the facts the Commission order "produces no arbitrary result," is precisely the same as if there were no right of review of any kind.

Existing Depreciation and Depletion.

Aside from the theoretical and argumentative assertions and conclusions as to facts and law which the Commission as a matter of uniform practice incorporates in its opinions in rate cases to justify its practice of treating "depreciation and depletion" as essentially a matter of mere accounting, the findings of purported "facts" are limited substantially to the following mixture of fact and conclusion reciting the supposed "informed judgment" of the Commission and its staff witness on the subject:

> "The Commission's staff presented a complete depreciation and depletion reserve requirement study, i.e., a computation of the reserves which should have been accrued had the Company properly recorded in reserves the accumulated cost of the property consumed in service. *A qualified staff engineer inspected the Company's properties,* analyzed its past experience and that of its predecessors, and estimated the over-all service lives of the property by classes. *He considered* service life data on other pipe lines, *and treated realistically both the physical*

and functional aspects of depreciation." (Emphasis added.)

(R. V. 1, p. 44.)

As a part of the foregoing, the Commission naturally found it necessary to find that "A qualified staff engineer inspected the Company's properties * * *." Such inspection was basic and essential *(R. V. 1, pp. 428, 430)* in the prepation of a "realistic" depreciation, depletion and service life exhibit to guide the Commission. The Commission in fact adopted and followed the Commission staff exhibit *(Comm. Ex. 15, R. V. 3, pp. 1127-1142)* thus prepared and offered in evidence *(R. V. 1, pp. 43-45)*. But it developed, as is now admitted *(R. V. 3, p. 1335)*, that the sole Commission staff witness on the subject of depreciation and service lives did not make a single inspection of any part of the pipeline system of the petitioner *(R. V. 1, pp. 450-451)*. The pipeline system of more than 4300 miles admittedly constitutes more than 70% of the Commission total "actual legitimate cost" of all facilities *(R. V. 3, Comm. Ex. 5, pp. 977-978; R. V. 1, p. 50)*. The witness testified that he made "field inspections of the Company's property * * * to observe" physical and functional depreciation *(Comm. Ex. 15, R. V. 3, pp. 1127-1128)*. The Commission also found that "he * * * treated realistically both the physical and functional aspects of depreciation." Thus, the Commission finding asserts a personal knowledge and an "informed judgment" which the witness admitted he did not possess. The fact is the witness did not inspect the pipeline system or any part of it. This fact cannot be obscured or dissolved by edict, administrative or judicial. The finding of the Commission to the contrary is not "supported by substantial evidence" or any evidence, but is directly contradicted by the Commission witness himself. Thus the Commission did not address itself to the evidence, which is its basic duty. Failure so to do is error as a matter of law.

On this state of the record, the Court of Appeals undertook to substitute for the discredited finding a finding of its own, to the effect that the witness was excused from making such inspection, and thereby receiving direct personal knowledge of "the physical and functional aspects of depreciа-

tion," in that "he was prevented from doing so by the refusal of the petitioner to dig the 'bell holes' and that instead his inspection of the retired pipe, and his examination of the Company's inspection reports, enabled him to form a reliable opinion concerning the average service life of this particular class of property" *(R. V. 3, pp. 1334-1335)*. *The Commission, of course, made no such finding (R. V. 1, pp. 43-45)*. Aside from the inaccuracy of the substitute finding *(R. V. 1, pp. 438-439, 489; Pet. Br. pp. 79, 81, 82; Pet. Rep. Br. pp. 31-47)*, this Court is not permitted to make a finding and substitute it for that of the Commission.

> "*The courts cannot perform the function which Congress assigned to them in absence of adequate findings. Nor are they authorized under §19(b) to make findings and substitute them for those of the Commission.*" (Emphasis added.)
>
> *Colorado-Wyoming Gas Co. v. Federal Power Comm.*, 324 U.S. 626, 634, 65 S. Ct. 850, 854.

The Court of Appeals *(R. V. 3, p. 1335)* ignored the fact that even if "the petitioner offered no evidence concerning the economic service life or depreciation rates, and as against its objections" to the insufficiency of the evidence of the Commission "staff witness," it does not follow, as stated, that the reviewing court "must conclude that the evidence is sufficient to support the Commission's ultimate findings and conclusions." The statutory standard that "the finding of the Commission as to the facts" must be "supported by substantial evidence" may not be rejected at will or at all by the courts. That, the Court of Appeals has done here. That Court heretofore has recognized and declared that "in the absence of substantial evidence" the action of the Commission is "the arbitrary exercise of power by administrative fiat and cannot stand" *(Colorado Interstate Gas Co. v. Federal Power Comm.*, 142 Fed. (2d) 943, 954). Moreover, on the "hearing" before the Commission, the burden of proof is on that body *(Public Service Comm. v. Colorado-Wyoming Gas Co.* (F.P.C.), 43 P.U.R. (n.s.) 205, 231; *Colorado Interstate Gas Co. v. Federal Power Comm., supra*, at page 954). Yet here that same Court has held that, since the petitioner did not deem it necessary to offer

counter-evidence on the issue under consideration, the Court *(R. V. 3, p. 1335)* "must" sustain "the Commission's ultimate findings and conclusions" without regard to whether or not such "findings and conclusions" were "supported by substantial evidence." Such a rationalization has no support whatever in law. Since the Court of Appeals "considered irrelevant" the statutory standard of *Section 19(b)* "the inquiry on review has not proceeded under a correct rule of law and it follows that the judgment of the Court of Appeals must be reversed" *(Connecticut L. & P. Co. v. Federal Power Comm.*, 324 U.S. 515, 532, 65 S. Ct. 749, 757).

As illustrating the disregard of the record by both Commission and Court of Appeals, the Commission, by "adjustment," added to the "depreciation reserve" of petitioner an item of $2,200,000 accumulated by a non-affiliate predecessor company, Kansas City Pipe Line Company, as "bond amortization" for the years 1908 to 1912 *(R. V. 1, pp. 39-40)*.

The Commission accounting witness who made the adjustment in question testified on direct examination:

> "From about *1908 to 1912* Kansas City Pipe Line Company had set up reserve for depreciation in the amount of $2,200,000. *This reserve was the result of receiving from Kansas Natural Gas Company as part of the rental for its line, an amount during those years equal to the bonds redeemed.* These amounts were included as rental in the accounts of Kansas Natural Gas Company.
>
> • • • • •
>
> "Q. In other words, from the records you determined the actual cost of that property (Kansas City Pipe Line Company) to be $3,893,031.58?
>
> "A. That is correct. Likewise Kansas Natural Gas Company failed to reflect in its records the accrued depreciation set up on the books of Kansas City Pipe Line Company ($2,200,000) *and this amount I have included in my record as an adjustment to the reserve for depreciation of gas plant in service.*" (Emphasis added.)
>
> *(R. V. 1, pp. 207-208)*.

In short, a reserve for "bond amortization" from 1908 to 1912 simply is appropriated and by "adjustment" translated

into "reserve for depreciation of gas plant." In this fashion, the round sum of $2,200,000 depreciation is accumulated in four years on property, the actual cost of which the Commission witness declared to be $3,893,031.58, including non-depreciables. This then is the wholly insufficient record upon which the Commission relies to justify the $2,200,000 "adjustment" of petitioner's depreciation reserve, of which we complain. This is arbitrary action. The Court of Appeals ignored this issue *(R. V. 3, pp. 1333-1335)*.

Natural Gasoline Operations of the Cities Service Oil Company.

The issue here presented is whether the Commission acted unlawfully in segregating the natural gasoline extraction plants of Cities Service Oil Company from the other properties of the Oil Company and treating such plants and the operation thereof "as if they belonged to petitioner" *(R. V. 3, p. 1336)*. This was done solely in reliance on the fact that the two companies are affiliates, in that the common stocks (not outstanding securities) of both are owned by Empire Gas and Fuel Company (Delaware). The two companies are separate in operation and from the beginning of *all* gasoline extraction operations in 1918 the plants and business of such extraction have been exclusively the properties of Cities Service *Oil* Company *(R. V. 3, pp. 1033, 1037)*. There is no evidence in the record that the gasoline extraction operations of the *Oil* Company herein involved are now, or were at any time, in fact or in law, the operations of this, the *Gas* Company, but carried on by it through the corporate structure of the Oil Company.

The Court of Appeals approved the Commission action on the false premise that "otherwise, a regulated gas utility would be permitted to syphon off its profits to affiliates through the guise of contracts * * *." It is said "If the extraction process is in reality an essential part of the business of transporting and marketing the natural gas, the Commission was justified in ignoring the contract between the two affiliates for the purpose of determining just and reasonable rates" *(R. V. 3, p. 1336)*. Apparently by this language the Court intended to approve the take-over of the *Oil* Company property and the assumption of complete rate-

regulatory authority over its properties and business in question. The *Oil* Company was not allowed even Federal income taxes on the 6½ per cent return allowed it by the Commission *(R. V. 2, pp. 805, 806, R. V. 3, p. 1021)*. As to this action the Court of Appeals is silent.

Concededly, the Commission in a rate case may inquire into the reasonableness of contracts between a "natural gas company" and an affiliate such as Cities Service *Oil* Company which is not a "natural gas company." If the contractual relation is not reasonable, the Commission properly may require appropriate adjustment thereof. Such procedure is standard practice. But the Oil Company "is to be treated as a segregated enterprise" even though the affiliate relation "may demand close scrutiny" *(Smith v. Illinois Bell Telephone Co.*, 282 U.S. 133, 144, 151-153, 51 S. Ct. 65, 67, 70).

See, dissenting opinion Judge Phillips *(R. V. 3, pp. 1347-1349)*.

The record facts are:

The natural gasoline extraction or processing plants of Cities Service *Oil* Company presently involved herein are situate at Wichita, Kansas, and Tallant, Oklahoma *(R. V. 2, pp. 787-788)*. The Wichita plant, which extracts natural gasoline from natural gas produced by petitioner in the Texas Panhandle field (being 47,392,302 M.c.f. in 1941, which amounted to 40% of petitioner's total deliveries of 117,459,914 M.c.f. in that year) *(Comm. Ex. 14, Sch. 1, R. V. 3, p. 1119)* is in excess of 250 miles from the Panhandle field. Between the field and Wichita that natural gas passes through five compressor stations *(Map, Comm. Ex. 14, R. V. 3, p. 1125)*. The Tallant plant extracts natural gasoline from natural gas purchased and produced in several Oklahoma fields which are located as much as 150 miles distant from such plant. Enroute to the Tallant plant, that gas passes through one compressor station *(Map, supra)*. The Wichita plant is much larger than the Tallant plant *(Comm. Ex. 11, Sch. 6, R. V. 3, p. 1031)* and produces 90% of the revenue here under consideration *(Comm. Ex. 11, Sch. 2, R. V. 3, p. 1023)*.

The Commission made a general "finding": "This operation is profitable and renders the natural gas more readily marketable and transportable. The extraction of gasoline and other residuals reduces the heat content and consumes a certain volume of the natural gas" *(R. V. 1, p. 53)*.

The sole witness for the Commission on this subject testified generally on direct examination that the extraction of gasoline and other residuals from natural gas is a necessary function of the business of transporting and delivering natural gas; gasoline and other residuals so extracted from natural gas are by-products of the pipeline business because the extraction of residuals from natural gas is essential to the transportation and sale of natural gas, and that natural gas, to be merchantable or suitable for commercial use, must be dry or free of moisture *(R. V. 2, p. 770)*.

This testimony, it will be observed, is not directed at all to the particular processing operations of the Cities Service *Oil* Company at its Wichita and Tallant plants, but is simply a broad conclusion as to the functions of natural gasoline extraction plants *in general*. This *only* engineering witness of the Commission did not present any facts or expert conclusions to afford any basis whatever for the Commission so-called finding quoted, *supra*. However, on cross-examination, he was forced to admit that much of the natural gas handled by petitioner was not treated for gasoline extraction; that the natural gas which was so treated traveled hundreds of miles before such treatment; that in fact whether natural gas was so treated by this petitioner was not dependent upon the fact of production or of purchase; and that the controlling and decisive consideration was whether or not there was sufficient gasoline content in the gas to make commercial operations profitable *(R. V. 2, pp. 773-774)*. The only evidence in the record, *and that is uncontradicted*, is: "The fact in this case is that the gasoline plants at Wichita and Tallant remove gasoline which could have been left in without harm to either the usefulness of the gas or its suitability for transportation." The same witness added that it was obvious that the removal of the gasoline from the natural gas at Wichita and Tallant plants is not required to facili-

tate the transmission of that gas, for "that gas had traveled hundreds of miles before it got to those plants" *(Miller, R. V. 2, pp. 775, 776)*. So the factual assumptions so easily indulged by the Commission *(R. V. 1, p. 53)*, unrelated as they are to the processing operations of this petitioner's gas, are not supported by and are contrary to the record. There is *no evidence* as to *amount* of natural gas consumed in the process or the reduction in heating value and the effect thereof, of which both Commission and its counsel talk.

The Commission accounting witness testified: "We acted as though one company carried on the entire transaction"; "I haven't attempted to make any adjustment in the price. I have taken an adjustment of the total earnings" *(R. V. 2, pp. 792, 802)*.

Thus the Commission, following the staff exhibit *(Comm. Ex. 11, R. V. 3, pp. 1019-1037)* deliberately expropriated the extraction plants, business and earnings of Cities Service *Oil* Company and made a collateral but complete rate case determination with respect to that business, in this case, in the absence of the *Oil* Company, and precisely as though the Oil Company were a "natural gas company subject to Commission rate-regulatory authority under the Gas Act."

The Court of Appeals attempted, however, by an inaccurate recital of the direct testimony of the Commission "staff witness" to justify the Commission action here, under "the theory" of *Cleveland v. Hope Natural Gas Company*, 44 P.U.R. (n.s.) 1, 27-28, where there were specific findings that "the extraction of gasoline and butane * * * is necessary to make the natural gas marketable and transportable," and "It is significant that Hope Natural Gas Company processed its own gas before 1920." Neither before the Commission nor on review *(Hope Natural Gas Co. v. Federal Power Comm.*, 134 Fed. (2d) 287, 307) did the Company raise any issue as to the propriety of such Commission action.

In this case, however, the "staff witness" in question did not testify that natural gasoline extraction "was a necessary function of" Cities Service Gas Company or that "such

process was essential to the transportation and sale of the natural gas" of this petitioner, or that the extraction process was "in reality" a part of this petitioner's business. *Moreover, the Commission made no such findings (R. V. 1, p. 53).* Here again then the Court *(R. V. 3, p. 1336)* has undertaken "to make findings and substitute them for those of the Commission," which, as we have seen, *supra,* it is not authorized to do.

The obvious assumption of this Court also is that the statutory standard of "substantial evidence" is met and satisfied by seizing upon some generalization of a witness which is without application to the particular case and without support of and contrary to *the known and uncontroverted facts.* Neither the Commission nor the reviewing court may so proceed. The entire record controls and must be examined and appraised *(Connecticut L. & P. Co. v. Federal Power Comm.,* 324 U.S. 515, 521, 534, 65 S. Ct. 749, 752, 758).[11]

Here then is action, arbitrary in fact and in law, to which the Court of Appeals has given its approval and affirmation.

Federal Income Taxes.

The essential facts and issues involved in this discussion have been quite fully detailed and presented in the foregoing petition for review, under the subject titles, "Questions Presented," "Summary Statement of Matter," and "Reasons for Granting the Writ," *supra.*

It is necessary here, therefore, to comment but briefly upon the impropriety and illegality of the Commission action *(R. V. 1, p. 57)* and the approval thereof by the Court of Appeals *(R. V. 3, p. 1337).*

The Court of Appeals *(R. V. 3, p. 1337)* made the amazing statement "* * * the Commission was certainly justified in refusing to allow the item as an expense, *because if it had permitted the item to remain in the total cost of service before allocation, it would have been justified in allocating the entire amount to the jurisdictional sales."* This declaration is an obvious *non-sequitur* and "a straw man" as well. The

idea that the Federal Power Commission conceivably would do that which that Court suggests as a danger is so fanciful as to merit no reply. As to the logic of the conclusion, it no more follows that Federal income taxes as an allocable item would or properly could be allocated entirely to "the jurisdictional sales" than any other item of allocable expense. As to either type of expense item, the Commission would not be "justified" in so allocating it, and its action, if it did so, would be just as arbitrary in fact and in law as is its equally extreme action here "in allocating the entire amount" of Federal income taxes to "the non-regulable sales."

Here again, as in previous subdivisions of its opinion, the Court of Appeals *(R. V. 3, p. 1337)* sought to buttress its conclusion by complaint that the petitioner "offers no affirmative computation tending to show its tax liability upon the permissible rate" and so "*we must assume* that the Commission statement * * * is correct" that it "did no more than allocate to the non-jurisdictional sales the cost of earnings which were solely attributable to it," (purely a conclusion of law) and, therefore, "it was legally justified in eliminating the Federal income tax liability as an item of cost." This argument of that Court evidences a complete misapprehension of the record as well as the law. The law is clear. There is no issue of fact. The issue is one of law. And as we have shown, neither the Commission nor the Court of Appeals has proceeded under a correct rule of law in this matter.

The error of law is made more abundantly clear by reference to the Commission brief herein before the Court of Appeals *(pp. 39-40)*, where it is said: "*If* all of petitioner's rates were subject to regulation and petitioner had been limited to an over-all fair return of 6½%, it would not have paid any Federal income taxes." This, counsel for the Commission state as the Commission "thesis." It is entirely hypothetical and supposititious. Let us apply the law to it: "If all of petitioner's rates"—*both regulable and non-regulable*—"were subject to regulation"—*which they are not*—"and petitioner had been limited to an over-all"—*regulable and non-regulable business*—fair return of 6½%—*which is*

beyond the authority of the Commission according to both the Gas Act and this Court—"it would not have paid any Federal income taxes." Nevertheless, and despite the law to the contrary, the Commission proceeded to dispose of Federal income taxes precisely as though its hypothetical "thesis" were in conformity with law.

> See dissenting opinion, Judge Phillips *(R. V. 3, p. 1349)*.

The fundamental misconception of the Court of Appeals *(R. V. 3, p. 1337)* was that Federal income taxes attributed by the Commission to the earnings of "the non-regulable sales" in excess of 6½% could not be "allowed as an expense" because, as the Court of Appeals erroneously *(Colorado Interstate Gas Co. v. Federal Power Comm.*, 324 U.S. 581, 588, 65 S. Ct., 829, 833) assumed, petitioner *"cannot lawfully earn"* more than 6½ percent upon "the non-regulable sales."

> See *Galveston Electric Co. v. Galveston*, 258 U.S. 388, 399, 42 S. Ct. 351, 356.

Since neither Commission nor Court of Appeals has proceeded under a correct rule of law, the order of the Commission and the judgment of the Court must be reversed *(Connecticut L. & P. Co. v. Federal Power Comm., supra)*.

Allocation of Cost of Service.

The treatment by the Court of Appeals of this subject is peculiarly inept. It is epitomized by that Court's declaration *(R. V. 3, p. 1339)* that "We shall not criticize that which we are powerless to correct." This statement leads us to observe that there are none so powerless as those who reject the very power they possess.

It is said also *(R. V. 3, p. 1339)* that "The appropriateness of the formula raises questions of fact, not of law," that "allocations 'require the exercise of *informed judgment* and use of procedures which appear to be *reasonable*' " in each case, that "If some of the specific allocations appear to be *illogical and unfair*, they necessarily pose *technological problems* of accounting and finance upon which the *admin-*

istrative judgment has been declared *virtually supreme*" and finally that "*If* allocation of cost of service is a fundamentally correct and permissible method * * * we cannot say on the record that the application of the formula *is so wholly unrelated to the facts* as to produce an illegal or reversible error." These statements taken together all add up to the proposition that the Commission conclusion that "the staff's method as applied was fair and reasonable" *(R. V. 1, p. 61)* is final, supreme and not subject to review under *Section 19(b)* of the Act. Accordingly, the reviewing court cannot make any independent determination as to whether the Commission addressed itself to the evidence or whether its determination was "reasonable" or "illogical and unfair" and, therefore, arbitrary.

Under such a view the Court of Appeals, as the statutory court of review, is prevented and prohibited from any determination whatever (adopting the language of Mr. Justice Douglas), of whether the Commission in the required "separation of the regulated and unregulated business" has "assigned" *in fact* any part of "the profits or losses, as the case may be, of the unregulated business * * * to the regulated business" and thus has proceeded to "transgress the jurisdictional lines which Congress wrote into the Act" *(Panhandle Eastern Pipe Line Co. v. Federal Power Comm.,* 324 U.S. 635, 641-642, 65 S. Ct. 821, 825). The Commission determination of this issue being, so it is said, "the exercise of informed judgment," and predicated upon "technological problems," the Commission becomes a law unto itself. Such is the ruling of the Court of Appeals. This is "illegal and reversible error."

This Court, speaking through Mr. Justice Douglas in the *Colorado Interstate Gas Company* case (324 U.S. 581, 589, 590, 591, 65 S. Ct. 829, 833, 834), declared:

> "* * * Congress indeed prescribed no formula for determining how the interstate wholesale business, whose rates are regulated, should be segregated from the other phases of the business whose rates are not regulated. * * * But we cannot say that under the Natural Gas Act the Commission can employ only one allocation formula and that that formula must entail a segregation of prop-

erty. * * * Allocation of costs is not a matter of the slide rule. It involves judgment on a myriad of facts. * * * *Under this Act the appropriateness of the formula employed by the Commission in a given case raises questions of fact not of law.* .* * *

* * * * *

"* * * Considerations of fairness, not mere mathematics, govern the allocation of costs."

As was also stated by Mr. Justice Douglas, speaking for this Court, in the *Panhandle Eastern Pipe Line Company* case (324 U.S. 635, 641-642, 65 S. Ct. 821, 825):

"We agree that the Commission must make a separation of the regulated and unregulated business when it fixes the interstate wholesale rates of a company whose activities embrace both. Otherwise, the profits or losses, as the case may be, of the unregulated business would be assigned to the regulated business and the Commission would transgress the jurisdictional lines which Congress wrote into the Act."

The question presented then in each case, where allocation is necessary, is whether there must be a "formal allocation" or a so-called "cost of service allocation" will suffice. Neither Commission *(R. V. 1, p. 59)*, nor Court of Appeals *(R. V. 3, pp. 1337-1339)* gave any consideration whatever to this question. Without either findings or attention to "considerations of fairness," it was *assumed* by the Commission that "the staff's method as applied was fair and reasonable" and "we * * * adopt it for the purpose of this proceeding" *(R. V. 1, p. 61)*. The Commission in fact departed both in method and in detail from the "cost of service" allocation of its staff *(Comm. Ex. 30, R. V. 3, pp. 1187-1213)*. It did not make reference to it in its opinion for purposes of reconciliation or otherwise *(R. V. 1, p. 61)*, where it is said by way of ultimate conclusion:

"We have allowed for expenses and return a total of $10,967,041. Rents and other miscellaneous gas revenues, totaling $121,782, should be credited thereto, leaving $10,845,259 as the total cost of service. Applying the staff's method of allocation, we find that $7,264,986 represents

the total cost of service (including a fair return) for the sales subject to our jurisdiction, and $3,580,273 represents the cost of service for the sales not subject to our jurisdiction."

(R. V. 1, p. 61).

It was declared by Mr. Justice Douglas, in *Colorado Interstate Gas Company* case (324 U.S. at 595, 65 S. Ct. at 836), referring to the alleged vagueness of the findings of the Commission on the "allocation of costs," of service, "The findings * * * leave much to be desired since they are quite summary * * *. But the path which it followed can be discerned."

In the *Colorado-Wyoming Gas Company* case (324 U.S. 626, 635, 65 S. Ct. 850, 854), on the other hand, the Commission having made some departure from the staff method, the case was reversed and sent back to the Commission for proper and disclosing findings.

In that case the late Chief Justice Stone, Mr. Justice Roberts, Mr. Justice Reed and Mr. Justice Frankfurter were of the opinion "that the case should be remanded to the Commission for separate allocation of investment and operating cost between the regulable and non-regulable properties, as well as for the clarification of findings directed in the opinion."

Certainly, under the authority of this Court, both the character and the substance of the allocation is a procedure of major importance, and because it is so subject to the likelihood or possibility of abuse, Commission action in that behalf must be carefully examined and considered in each case by the reviewing court to insure that the Commission does not "transgress the jurisdictional lines which Congress wrote into the Act."

In this case, what is the "path" which must be "discerned" from "the findings"? How is that "path" disclosed?

The foregoing "findings and conclusion" of the Commission in this case tell us where the Commission *declared it started* and next tell us the final result, which it is said

attains "all that can be accomplished by an allocation of physical properties." Obviously, an allocation of physical properties would disclose the portions of the property, described either in terms of percentages or of dollars, allocated to the regulated operations and to the unregulated operations, respectively, and the actual amount of return apportioned to the jurisdictional and non-jurisdictional operations.

Yet it is significant that there is no Commission finding *(R. V. 1, pp. 59-61)* or other disclosure in the entire record either in percentages or in dollars, showing the property and return allocated to each class of the business, that is, to the regulated property and business and to the unregulated property and business. This part of "the path" is completely obscured.

Consequently, it is impossible to determine or even examine into, the question of whether the ordered reduction in the rates and charges of the regulated part of the enterprise produces an arbitrary result, with respect to the *undisclosed* portion of the property, business and earnings which the Commission, by its "method," purports to allocate to the regulated business. And certainly the test of financial stability declared by Mr. Justice Douglas as a measure of the reasonableness or unreasonableness of the "end result" of the rate reduction order cannot be applied in the absence of some actual separation in dollars or percentages in the property and earnings of the regulated and unregulated operations.

It cannot be denied that "allocation" reaches the very heart of and directly and substantially controls the amount of the ordered reduction. It is obvious that the Commission processes and procedures can be and have been altered, in this and in other cases, at will and without explanation as to the controlling considerations of law and fairness substantially to effect the amount of the rate reduction order.

The Commission treatment of "Federal income taxes" and of the alleged "excess earnings" from the natural gas extraction operations are illustrative of the unlimited range of "discretion" exercised by the Commission in its "allocation" processes.

The Commission staff witness *Orme*, who prepared and presented *(R. V. 1, p. 811)* the Commission Exhibit 30, entitled "*Cost of Service and Allocation of Cost of Service*" *(R. V. 3, pp. 1187--1213)*, testified that he had never before prepared such "a cost allocation" *(R. V. 1, p. 825)*. Nevertheless, he proceeded to sort out, classify and apportion expenses as between "Commodity Costs" and "Demand Costs," as he defined them *(R. V. 1, p. 819)*, without any factual or other explanation whatever as to the basis of the classification and apportionment of such "Costs" embodied by him in the exhibit in question *(R. V. 3, pp. 1201-1211)*. Such is the "staff's method" which the Commission concluded was "fair and reasonable" *(R. V. 1, p. 61)*. The open end and uncontrolled character of the "Cost of Service Allocation" so prepared by the witness is illustrated by the following testimony given by him:

> "*Such allocations require the exercise of informed judgment and the use of procedures which appear to be reasonable in view of the particular operations and characteristics of the system in each case.*" (Emphasis added.)
>
> *(R. V. 1, p. 812.)*

This highlights both the infirmity and the danger inherent in the undisclosed and uncontrolled allocation procedures and processes of the Commission, which we are told by the Commission is the so-called "demand and commodity" method and which the Commission generally describes *(R. V. 1, pp. 59-60; Comm. Br., pp. 42-45)*. That is all that is forthcoming except the final result, and that is not broken down even as between expenses and return *(R. V. 1, p. 61)*.

This entire technical question of allocation, from a legal point of view, is in confusion and clouded with suspicion. As yet it has not received from the courts the judicial consideration and study which it must have, if it is to be removed from the range of the uncontrolled and non-reviewable discretion of the Commission, which is the present state of affairs.

End Result and Due Process.

The Commission order, which includes the opinion *(R. V. 1, p. 66)*, "in its entirety" is inter-related throughout. The amount of "rate reduction available" *(R. V. 1, p. 61)* is intimately connected with and results directly from the "excess earnings" and the "allocation" thereof *(R. V. 1, pp. 58, 61)*. The "excess earnings" in turn stem from "income available for return" *(R. V. 1, p. 58)*. This, in its turn, is produced by subtracting "expenses" from "gross revenue," after which the return allowed is applied to the "rate base." Obviously, if any of the many essential and supporting Commission conclusions or findings are not "supported by substantial evidence," is inconsistent with the evidence, or is without authority of or contrary to law, the Commission's order crumbles. This follows logically as a matter of ordinary sense and common understanding. Such is the inevitable relation of cause and effect. And such is the law—as declared by this Court *(Natural Gas Pipeline Company* case, 315 U.S. 575, 586, 62 S. Ct. 736, 743).

Before the "end result" doctrine can come into play four prerequisites must be met according to the declaration of this Court in the *Natural Gas Pipeline Company* opinion, *supra,* to-wit: (1) "a fair hearing," and all that is involved therein under law, (2) "proper findings made," (3) "statutory requirements satisfied," both by Commission and Court, and (4) "limits of due process" must not be "overstepped." These four prerequisites are not mere words; they relate to the *substance of rights and duties* under our constitutional system.

It is to be recognized that the order *"in its entirety"* in this case comprehends some 17 enumerated findings and conclusions, as well as the entire opinion incorporated therein by express reference *(R. V. 1, pp. 66-69)*. Moreover, "the facts before it" (the Commission) are *all* the evidentiary matters in the record. These then are the measures and guides which this Court, in conformity with constitutional requirements and its uniform decisions has declared must be "viewed" on review. The reviewing function of the courts is judicial and "does not trench upon, or involve the

exercise of, administrative authority" nor can it "be regarded as an attempt to vest in the court an authority to revise the action of the Commission." It is government by law.

It is evident from the record in this case and the law applicable thereto, which have been examined and presented generally, *supra,* that the Commission has proceeded in reliance upon the erroneous construction and application of the law as related to numerous issues; that it has failed to make essential findings; that many of such findings as it did make respecting material and substantial issues are not supported by "substantial evidence"; and that "the end result of its rate order" is "arbitrary."

The Commission produced a forced result, not alone by refusal to receive evidence which was relevant, competent, material and vital to petitioner in this proceeding, but also by misapplication of the evidence under assumptions contrary to fact. The order cannot be made effective without depriving the petitioner of its rights and properties contrary to the requirements of due process of law.

The Court of Appeals indulged assumptions freely but made no real inquiry into the state of the law applicable to the various issues in this case.

The Court of Appeals by the cumulative presumptions and burdens of proof which it has imposed upon this petitioner and by the numerous obstacles which it has erected to obstruct its own judicial path, has rendered completely nugatory the judicial review to which this petitioner is of right entitled under *Section 19(b)* of the Gas Act. That Court indulged recital after recital throughout its opinion to explain why it was unable to decide or even to examine into the question of abuse of the administrative "discretion" and "prerogatives."

"Of what avail" are the powers, the duties, the requirements and the limitations of the Natural Gas Act and other controlling law of the land as declared and enforced throughout the years by the orders and mandates of this Court, if they can be ignored, disregarded and "overpassed with impunity by the very agencies of government"—in this case,

the Commission and the Court of Appeals—which were created and directed to execute, preserve and enforce them!

Wherefore, respectfully, this petitioner asks this Court fully to review this case to the end that grievous and irreparable injury be not inflicted upon this petitioner and that the present uncertainty and confusion in the law be clarified and settled.

Respectfully submitted,

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APPENDIX A.

Pertinent Sections of the Natural Gas Act. (15 U. S. C. 717.)

NECESSITY FOR REGULATION OF NATURAL-GAS COMPANIES.

Section 1. (a) As disclosed in reports of the Federal Trade Commission made pursuant to S. Res. 83 (Seventieth Congress, first session) and other reports made pursuant to the authority of Congress, it is hereby declared that the business of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest, and that Federal regulation in matters relating to the transportation of natural gas and the sale thereof in interstate and foreign commerce is necessary in the public interest.

(b) The provisions of this Act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

RATES AND CHARGES, SCHEDULES, SUSPENSION OF NEW RATES.

Section 4. (a) All rates and charges made, demanded or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

* * * * *

(e) * * * At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over

other questions pending before it and decide the same as speedily as possible

FIXING RATES AND CHARGES; DETERMINATION OF COST OF PRODUCTION OR TRANSPORTATION.

Section 5. (a) Whenever the Commission, after a hearing had upon its own motion or upon complaint of any State, municipality, State commission, or gas distributing company, shall find that any rate, charge, or classification demanded, observed, charged, or collected by any natural-gas company in connection with any transportation or sale of natural gas, subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory, or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order. * * *

ASCERTAINMENT OF COST OF PROPERTY.

Section 6. (a) The Commission may investigate and ascertain the actual legitimate cost of the property of every natural-gas company, the depreciation therein, and, when found necessary for rate-making purposes, other facts which bear on the determination of such cost or depreciation and the fair value of such property.

REHEARINGS, COURT REVIEW OF ORDERS.

Section 19. (b) Any party to a proceeding under this Act aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the Circuit Court of Appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be served upon any member of the

Commission and thereupon the Commission shall certify and file with the court a transcript of the record upon which the order complained of was entered. Upon the filing of such transcript such court shall have exclusive jurisdiction to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended (U.S.C., title 28, secs. 346 and 347).